S. Hrg. 99-879

FEDERAL MANAGEMENT REORGANIZATION, COST CONTROL, AND LOAN ACCOUNTING REFORM

HEARINGS

BEFORE THE

COMMITTEE ON GOVERNMENTAL AFFAIRS UNITED STATES SENATE

NINETY-NINTH CONGRESS

SECOND SESSION

ON

S. 2230

TO IMPROVE THE MANAGEMENT OF THE GOVERNMENT BY ESTABLISHING AN OFFICE OF FEDERAL MANAGEMENT IN THE EXECUTIVE OFFICE OF THE PRESIDENT, AND FOR OTHER PURPOSES

AND

S. 2142

TO ASSURE THE PROPER BUDGETARY TREATMENT OF CREDIT TRANSACTIONS OF FEDERAL AGENCIES AND TO REDUCE THE FEDERAL BUDGET DEFICIT

MAY 13 AND 14, 1986

Printed for the use of the Committee on Governmental Affairs

U.S. GOVERNMENT PRINTING OFFICE
63-272 O WASHINGTON : 1986

For sale by the Superintendent of Documents, Congressional Sales Office
U.S. Government Printing Office, Washington, DC 20402

S401-8

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FEDERAL MANAGEMENT REORGANIZATION, COST CONTROL, AND LOAN ACCOUNTING REFORM

TUESDAY, MAY 13, 1986

U.S. SENATE,
COMMITTEE ON GOVERNMENTAL AFFAIRS,
Washington, DC.

The committee met at 9:38 a.m., in room SD-342, Dirksen Senate Office Building, Hon. William V. Roth, Jr. (chairman of the committee) presiding.

Present: Senators Roth, Durenberger, and Eagleton.

OPENING STATEMENT OF CHAIRMAN ROTH

Chairman ROTH. The Committee on Governmental Affairs is convening today to hear testimony from a number of experts on two major legislative initiatives. The Federal Management Reorganization and Cost Control Act, S. 2230, which I introduced late last March, is an omnibus effort to reorder and revitalize the central management structure of the Federal Government.

This bill would institute fundamental reforms in the Government's management system for accounting, financial reporting, and for cash credit and debt collection management and also for information resources management.

The Loan Accounting Reform and Deficit Reduction Act, introduced by Senator Trible, is a companion measure in the area of credit management. I strongly support the approach taken by this bill. Senator Trible's bill and the House counterpart, offered by Congressman Bill Gradison, represent a major departure in the way we treat new loans made by the Federal Government to private borrowers. Under the provisions of S. 2142, all new Government loans will be sold by the Treasury in the private securities markets. With this approach, for the first time, we will have an accurate accounting for the amounts of subsidies granted for these loan programs, and we will have these subsidies squarely identified on the budget, by lending agency.

Nearly all of us who have worked to improve Federal management begin with the understanding that the most pointed responsibility for excellence in Federal management rests ultimately with the President as the Nation's Chief Executive. And yet the real opportunity for achieving excellence in Federal management is to be found in the agencies, not in the Presidency.

The President of the United States is not, as some suggest, like the president of a large corporation. He is more like the chief executive of a huge holding company of many separate and diverse enterprises.

Still, there are critical management issues that cut across agency and departmental boundaries: The need to find and develop leadership for effective management, to organize government for full-performance service delivery, and to develop and maintain effective overall systems for financial management, procurement and for the management of information and records.

Only the President can offer the overall managerial policy leadership that is necessary in this area. But to provide that leadership, the President needs help. He needs the tools to do the job, the sustained institutional resources to provide accurate information and competent advice, and to make sure that his management policy objectives are implemented. It was for this job that the Office of Management and Budget was created in 1970.

Ironically, it was after the word "Management" was added to the name of the Nation's budget office that the management functions there began to erode. In study after study—most recently in a series of studies prepared for this committee by the Congressional Research Service and issued 2½ months ago—OMB is shown to have greater and greater responsibility for management, but fewer and fewer resources to shoulder them.

What little management capacity remains in OMB is openly acknowledged to be "budget driven" and some would say "driven out" by the budget side of OMB. For the most part, management at OMB has alternated between direct intervention into agency management and official, but largely ineffectual, urgings to agency managers to examine their operations more critically. Recently, the emphasis has turned to a more top-down approach with heavy emphasis on consolidation of administrative systems, cutting costs and improving efficiency. We have seen little regard for developing managerial leadership or organizational and managerial systems capacity for the most efficient and effective delivery of Government services. This is hardly the kind of sustained management assistance that the President needs.

It is for this reason that S. 2230 provides for the creation of an Office of Federal Management.

Within that office, there will be an Administrator for Financial Systems with clear authority and responsibility for coordinating and upgrading Federal financial management. Nowhere is the need for management reform greater than in our financial and accounting systems. Unfortunately, modern and efficient systems are not now widely available to the Government's financial managers.

It is now 35 years since passage of the Accounting and Auditing Act of 1950, which mandated agency adoption of modern accounting and internal control systems as determined by the Comptroller General. Yet there are now over 400 different accounting systems to be found in the Federal Government.

They are not only incompatible, but the majority of them, according to the agencies' own reports, are substandard and inadequate. Severe weaknesses in the Government's accounting and internal control systems are draining billions of dollars each year from the delivery of services to the people who need them.

We are all aware of the scandalous waste associated with the Department of Defense, its overpricing of spare parts, and its inefficient procurement and acquisitions procedures. But few people know that the Government now has a backlog of almost $24 billion in delinquent nontax debts, up 55 percent since the beginning of fiscal year 1983. The uptrend in uncollected debt owed the Government has come despite passage of the Debt Collection Act of 1982, which demanded that Federal agencies adopt private sector collection practices.

Audit reports recount a litany of collection horror stories such as writing off debts as uncollectible after merely sending the debtor two notices of past due amounts and, even worse, simply ignoring debt collection or treating it as an afterthought.

Weaknesses such as these in the very structure of our financial management system simply must be corrected. No further delays can be tolerated.

We must, of course, acknowledge that the President has actively pursued a management reform agenda, and we support his leadership. His reform '88 and productivity initiatives, along with past legislative efforts, have begun to provide more cost-efficient and streamlined management systems.

But we have yet to take on a more comprehensive approach in reforming the actual structure for Federal management reform, implementing needed accounting and internal control systems, and installing effective procedures and incentives for cash and credit management, debt collection, and information resources management.

That is what S. 2230 and S. 2142 are designed to do.

At this time, I am very pleased to call forward my colleague, Senator Paul Trible, and my good friend Representative Bill Gradison.

Gentlemen, I am delighted to have you here today. I want to congratulate you, Paul, for your initiative and as the author of S. 2142. I congratulate you, Bill, for the role you are playing in companion legislation in the House.

Please proceed.

TESTIMONY OF HON. PAUL S. TRIBLE, U.S. SENATOR FROM THE STATE OF VIRGINIA, AND HON. WILLIS D. GRADISON, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF OHIO [1]

Senator **Trible**. Mr. Chairman, Congressman Gradison and I appreciate your warm welcome and also your kind words about our legislative initiative.

Mr. Chairman, we share your conviction that improved management of Federal programs is both possible and necessary and that failure to make improvements is unacceptable at this time of severe budget restraint.

We applaud your efforts to implement Grace Commission recommendations on Federal management. You and your staff are to be applauded. I would hope to have the opportunity to cosponsor your legislation.

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[1] Representative Gradison's prepared statement may be found on p. 196.

When your bill is reported, I hope that it will incorporate our legislative proposals found in the Loan Accounting Reform and Deficit Reduction Act. Senate bill 2142 and the compansion measure that Bill Gradison has introduced in the House of Representatives would make a significant contribution to your goal of improved Federal credit management. It also responds constructively to the Senate's 1987 budget resolution, which calls for fundamental reform of credit budgeting.

Congress and the administration have now recognized the feasibility of deficit-reducing loan sales. As you well know, in 1986, the Congress authorized the sale of rural housing loans. This year's Senate budget resolution assumes the sale of eight different categories of loans.

While the feasibility of loan sales to reduce the deficit is generally accepted, we have paid insufficient attention to the improvements in budgeting loan sales would make. Rather than proceed in a piecemeal fashion, we believe it is time to adopt a policy of selling all new loans.

The Federal Government is far and away the Nation's largest lender. Last year, it made $53 billion in direct loans, and it is projected that Federal loans will average $37 billion a year over the next 3 years.

Despite the magnitude of these figures, we know very little about the true budgetary impact of lending. Current accounting practices do not allow us to ascertain the true cost of the loan, the amount of the subsidy, or to make meaningful comparisons among the scores of loan programs.

The many defects in the current accounting system are discussed at length in my introductory statement to Senate bill 2142 in the Congressional Record, and in the 1984 CBO report "New Approaches to the Budgetary Treatment of Federal Credit Assistance," and I would ask, Mr. Chairman, that at the conclusion of my testimony, that introductory statement be made a part of the record.[1]

These shortcomings need not be enumerated again here today, but they can be eliminated by the single reform contained in our legislation: loan sales.

Under the provisions of our legislation, all future Federal loans would be sold to private investors. The Federal Government would not, I repeat, would not guarantee the repayment of these loans.

Let me briefly describe how this process would work. The Government would make a loan, and the loan would be treated as an outlay. The loan would then, in turn, be sold to the highest bidder. The proceeds from the sale would then be credited to the agency as offsetting receipts.

As a result, the subsidy cost—the difference between the amount lent and the market value of the loan—would appear in the agency's budget. By applying this procedure to all loan programs, we would measure the amount of the subsidy, attribute it to the appropriate agency, and control the program through appropriations. Each year, an agency would make and sell loans and incur subsidy costs equal to the amount appropriated to the lending program.

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[1] See p. 202.

In short, we would know the cost, and knowing something about costs, as you well know, can make a profound difference.

First, it would dramatically improve Federal budgeting. Identifying the amount of subsidy will allow the Congress to make meaningful comparisons among loan programs and between loans and other forms of assistance.

Second, it will help us target assistance so that Federal dollars can be used as effectively and efficiently as possible.

Third, it will relieve pressure on loan programs, whose costs are now overstated by current accounting practices.

Now, there is one additional benefit: Loan sales will reduce the Federal deficit by accelerating loan repayments. In essence, the Government would have its loans repaid immediately. CBO has suggested that loan sales will reduce the deficit by $67 billion over the next 5 years.

In sum, Mr. Chairman, we have the opportunity to rationalize a process that has, for too long, been obscure. Again, I would urge that Senate bill 2142 be included in your more comprehensive legislation.

I thank you for the opportunity to testify here today with my good friend and former colleague in the House, Bill Gradison.

Chairman ROTH. Bill.

Representative GRADISON. Thank you, Mr. Chairman.

I am pleased to join with my good friend, Senator Trible, today in support of his bill, S. 2142. I commend you, Mr. Chairman, for holding this hearing, especially for your efforts to improve the management of the Federal Government.

As a result of this hearing, I hope you will find that S. 2142 is both compatible with and complementary to your more comprehensive legislation and that you will incorporate it into your bill.

Mr. Chairman, the most important requirement for sound management is good information. This is equally true for policymaking. Yet one area of Government, Federal credit programs, stands out for its demonstrably poor quality of information. We know, for example, that the Federal Government originated $53 billion in direct loans last year, but we can only guess as to the cost of these loans.

In fact, the situation goes beyond poor quality of information because the information we do have actually misrepresents the facts.

The extension of Government credit under terms and conditions more favorable than a recipient can otherwise receive constitutes an uncompensated risk borne by all Americans, whether or not the loan is repaid with interest. Furthermore, by moving recipients to the head of the credit line, Government credit programs necessarily rearrange the pecking order for creditworthiness, causing some to pay less and some to pay more for credit. This is surely the consequence, if not the intent, of the public policies.

It means that as a matter of policy, we are reordering the allocation of resources within our economy.

I would stress that there is nothing, absolutely nothing inherently wrong with this. After all, that is the purpose of the Government programs, to provide a benefit or otherwise convey a subsidy.

The issue is not whether a subsidy is involved, but rather, what the subsidy is. The problem arises because current budget practices record loan disbursements as current year outlays. This obviously overstates their true cost.

On top of this, outlays for direct loans are offset by repayments, which further muddies the situation. It is difficult to imagine a bank recording its lending activities this way.

The sole purpose of our bill is to correct this problem by reflecting in the budget the actual subsidy of direct loans. It would do so by requiring the Government to employ practices that are commonplace and routine in the private sector.

In order to determine the true subsidy value, S. 2142 would require that new direct loans be sold to the public without a Government guarantee. This is consistent with economic theory and common sense, both of which tell us that the discount demanded by the market, that is, the difference between the loan's face value and its selling price, is the value of the subsidy conveyed. This is why we call it the "market plan." Mr. Chairman, in the interest of time, I would ask that my full statement be made part of the record, and I would like to focus on three points:

The first point concerns the necessity of selling loans without a Federal guarantee. The objective of the market plan can only be realized if the loans are sold without recourse. If loans are sold with recourse, we merely raise the cost of the program while moving the cost completely off the Federal books. It is a double whammy, and, needless to say, we are still in the dark when we are finished with respect to the subsidy costs.

The problem can be traced to the absence of credit considerations in the 1974 Budget Act. The explosion of Federal credit in the 1970's can be attributed in no small part to the constraints put on noncredit spending by the Budget Act of 1974. The loopholes enjoyed by credit programs were closed, or so we thought, by Gramm-Rudman-Hollings, which requires that all agency transactions with the off-budget Federal Financing Bank be recorded on budget and in the accounts of the agency actually conducting the program.

But as the ink was still drying on Gramm-Rudman-Hollings, Congress legislated exceptions to this change. In H.R. 3128, the recently passed reconciliation bill, exceptions were carved out for the rural housing and SBIC loan programs. As a result, these programs are now prohibited from using the FFB. Instead, they must use private financing but with a Government guarantee.

The upshot is that these programs are more costly while at the same time appearing costless.

And the administration is also trying accounting ledgerdemain to hide the true costs of credit programs. A good example is their proposal for treating the Eximbank's loan programs which would reclassify the activity from a direct loan to a guarantee program.

In short, Mr. Chairman, the incentives to misstate true costs are greater now because of the public's strong concern over the deficit as well as changes intended by Gramm-Rudman-Hollings. There is a strong push to hide the true costs and nature of Federal credit programs by substituting financing from the public for financing from the Treasury. Yet a promise by the Government to stand behind the principal and interest of a private note is no different than the direct Government loan, and it ought to be reflected that way in the Federal budget.

My second key point concerns implementation of the market plan. I would acknowledge that as presently drafted, it may be overambitious. For one thing, it would require all new loans to be sold. Clearly, this is more a theoretical ideal rather than a practical possibility in the short run. If only for political reasons, it will be necessary to pilot test the market plan with a limited number of loan programs.

In addition, in order to maximize the return to the Government, it will be necessary to provide considerable structure to the loan assets. This includes standardizing loan accounts for specific programs and selling them in pools. It should go without saying that agency requests and justifications for appropriations should be dramatically improved so that the assets can be rated in a useful way to potential investors.

We must also determine the best way to manage the market plan in the executive branch within and between various agencies. Much of this, I think, can be delegated to the executive, but whether dictated by Congress or delegated, we must ensure substantial input from those in the private sector who are far more knowledgeable about and experienced with financial asset sales than we are.

I would suggest the market plan, Mr. Chairman, is essential to meet the requirements of your proposed legislation. Specifically, section 3811 of your bill would require all legislative proposals for new credit programs "to state any subsidies in direct or guaranteed loan programs." In frankness, I don't see how this can be implemented without experience gained by actual sales of Government financial assets, which would permit us to measure what the subsidy is.

Finally, Mr. Chairman, I want to stress what the market plan would and would not do:

It would determine the true subsidy costs of the Federal direct loan programs. From a fiscal policymaking perspective, it would require Congress to recognize the cost of credit programs before providing their budgetary resources through budget authority.

The market plan would not change the terms of any credit program. It is not privatization, and agencies would continue to select beneficiaries.

Importantly, there need be no loss of Government discretion over matters such as forbearance; to the extent such terms and conditions are articulated in contracts, they would be reflected in the discount.

The market plan excludes CCC loans, because they are not really loans but, rather, deferred purchase agreements. Nor does it include the activities of Government-sponsored enterprises such as Fannie Mae or Sally Mae. Nor does the market plan provide for selling the Government's existing loan portfolio. Only new loans would be sold.

In short, Mr. Chairman, the market plan would dramatically improve the quality of both policymaking and management by the Federal Government.

Thanks for giving me this opportunity to appear before your committee.

Chairman ROTH. Thank you, gentlemen. I want to congratulate both of you for your excellent work in this area.

I agree that the concept is worthy of pursuit. I also agree that perhaps it would be a little ambitious to try to include everything immediately. We do intend to proceed with your proposal and look forward to working with you.

I think that the practical approach is to incorporate it as part of the legislation that hopefully will be reported out by this committee. In the meantime, I would say I think both of you have material you wanted added. Your full statements will be included, of course.

Did you have something further?

Representative GRADISON. No. Thank you, Mr. Chairman.

Senator TRIBLE. Thank you, Mr. Chairman.

Chairman ROTH. Thank you very much. I appreciate your being here.

I am very pleased to have as our next witness Representative John R. Kasich of Ohio, who has introduced the omnibus debt collection credit management bill of 1986 in the House.

TESTIMONY OF HON. JOHN R. KASICH, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF OHIO [1]

Represenative KASICH. Thank you, Mr. Chairman. First of all, I want to express my deep appreciation to you for holding hearings into a subject that is so critical yet, I think, so misunderstood, or I may even say ignored. My view is that the more the Members of both the House and the Senate get into this area, the more we are going to find that there are an awful lot of fallow fields out there for plowing and an awful lot of revenue that can be brought into our Treasury to help with our budget problems. It will make taxpayers in all of our districts and in your State and in States across the country feel very, very good.

I am a sponsor of comprehensive debt collection legislation, and I strongly believe the Government's debt collection and credit management procedures need to be reformed and greatly strengthened.

Mr. Chairman, the Federal Government is owed $60 to $70 billion in overdue debt, although the figure is an educated guess. Let me point out that the $60 to $70 billion includes IRS debt, but about $25 of it is non-IRS. The GAO, which has, by the way, done an outstanding job in trying to analyze the problem—will tell you that they are not even sure that it is $60 or $70 billion; it could be $80 billion, since no one in the Federal Government really knows how much is outstanding because there isn't a very good accounting system.

The debt has grown at the rate of $50 million a day since 1984, and that, of course, comes on the heels of the passage of the Debt Collection Act of 1982.

The largest single amount, some $35 to $40 billion, is primarily due the IRS for back taxes, but the remaining $35 to $30 billion is spread literally throughout the entire Federal Government.

In other words, the sheer width and breadth of the overdue debt problem is just as astonishing as the amount which is overdue. A review of delinquency reveals that Government makes financial assistance available to just about anyone to do just about anything. However, in far too many cases, the Government loan and credit assistance programs have only been concerned with providing financial help as quickly as possible.

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[1] Representative Kasich's prepared statement may be found on p. 205.

There is so much emphasis being placed on spending taxpayers' money that little or no consideration has been given on how to effectively collect what is due. Although much public attention has been given to student loan defaults, which is how many of my constituents hear about with this problem, along with similar difficulties in HUD and SBA programs.

When the GAO came in and gave us a list of all the delinquencies, we started calling all the agencies, departments and bureaus, and we started asking them, "Why is it that in the NOAA program—" that is the program that allows people to borrow money in order to buy commercial fishing boats, "there is $27 million that is defaulted?"

We talked to about 25 different agencies, bureaus and departments in the Federal Government, trying to figure out what was going on and what kind of a system they had to check and collect overdue debt.

We were able to obtain an internal memo out of NOAA that says that whenever the agency wanted to proceed, in terms of collecting the collateral that was ensuring the guaranteed loans, it took as long as 2 years for the Justice Department to act because of the big backlog in litigation of debt related cases.

I will get to the amount of backlog, but the fact is that the internal memo stated that what you find is that because of different priorities, there is very little emphasis within the Justice Department to go forward and try to litigate these cases.

In fact, the memo said there is almost an unwillingness to do it, and that, of course, creates very serious problems.

There is $68 million in debt relating to the Department of Defense Selective Reenlistment Bonus Program. I can tell you that people within the Department of Defense have told me that the IRS has been less than cooperative in terms of sharing data about people who were given bonuses and either went AWOL or were booted out of the service, and must repay their bonuses.

The IRS has been reluctant, in many cases, to share information that DOD needs to track these people down.

So you have got somebody living in Dayton, OH, who was paid $25,000 to reenlist and DOD wants to go and find him and they can't because the IRS won't share the information.

In some cases they help, but in other cases, they simply wouldn't agree to do anything.

There is $30 million in loans that we made to doctors.

Chairman ROTH. Could I ask you a question?

Representative KASICH. Yes, sir.

Chairman ROTH. Did you ask IRS why they were unwilling to cooperate more?

Representative KASICH. My staff has been in touch with several IRS folks to say, "What is going on?" Their concern is a question of the Privacy Act and what their obligation is in terms of maintaining privacy, and they, frankly, felt as though there was not a clear indication from Congress in the 1982 Debt Collection Act in terms of whether they could share their information.

Now, they shared it with one branch of the service, but not with another branch of the service. I didn't go to the generals; I went to the people who were running the program, and they said:

> John, you may find out that some people on top will tell you we are getting cooperation, but we are involved in this, and we are not getting cooperation from the IRS.

There is $30 million in loans that we made to doctors. Basically, we gave them a free education and stipends to go to college. What do they have to do? For every year they got a free education and their stipend, they have to practice medicine in a rural area. What happens? They got the money, they got the stipends, they walk away from their obligation to practice in these rural areas, and of course, the Government is left holding the bag to the tune of $30 million for these physicians.

You may recall, Senator Roth, because I think you were involved in the Maritime Administration, an instance where a company got a $65 million loan from the Federal Government to burn toxic wastes at sea.

Now, this guy called me up and said, "We are going to burn toxic wastes at sea." I said, "What are you talking about?" I couldn't even imagine what he was saying, but the Federal Government loaned him, out of the Maritime Administration, $64 million. They built the ships, and then when they went to EPA to get the permits, take a guess at what the EPA said. They, of course, said no, and the company went belly up and the ship is drydocked somewhere off the east coast.

You probably won't be able to seize that thing for a couple of years because of the litigation backlog at Justice.

We are in the red to the tune of $347 million right now in the Maritime Administration, and I am being told that of the $6 billion portfolio, that as much as one-third is being questioned right now in terms of the stability of that fund.

There is $209 million from uncollected timber, mineral and surface mining fees and fines due the Interior Department.

This is one of two books. Every page is filled with people who owe money to the Federal Government, but we are not collecting it. The interesting thing about this program is that for every dollar collected under this program, 50 cents of it goes to the States, so when we look at a problem of revenue sharing and we have got $209 million, it is not a lot of money, but I tell you, you give a couple of my counties $15,000 or $20,000 to fix the roads in some of the rural areas; that is a pretty good chunk of money.

We ought to be chasing these folks down. We ought to be forcing them to pay, when you are talking about a couple hundred million dollars.

There is $106 million in unpaid import duties that are due the Customs Service. We were told, and we were not able to get the memo, but somebody out of Customs told us that there is a law firm in Miami that sent out letters to importers telling them how they could drag out, in litigation, the final determination of what is owed to the Customs Service.

For example, when you bring your goods in, there is an estimate of import duties made, and later a final settlement. This law firm is saying that, "We can tell you how to drag this process out so you have the use of the money, and we will just appeal this thing."

It is just not a system that makes much sense.

There is $11 million owed in travel advances by State Department employees. You know, when you go overseas and you are in the State Department, you get that advance. There is $11 million owed in travel vouchers, and you know what the State Department will tell you? "It will take us 2 years to put an accounting system in place that will make any sense." This was pointed out to the GAO, I think, as long as 1 year ago, that they should have cleaned this thing up, and they now have the gall to say that, "It is going to take us 2 years to put a system in effect that forces people to file their vouchers and to turn in their extra money." It makes no sense to me.

Despite the fact that we enacted the Debt Collection Act of 1982, the above examples—and I could give you a lot more—clearly show the Federal bureaucracy is still experiencing major problems with debt collection.

Since fiscal year 1982, overdue debt has almost doubled, and the amount of delinquencies continue to grow.

In 1984, the Federal Government wrote off $3.5 billion in delinquent debt, and believe me, I don't think much effort was made to try to collect it.

About $1 billion of it was IRS related, and I think the IRS is, overall, doing a pretty darn good job. I am glad we are going to beef up their staff.

The $2.5 billion that is non-IRS, I doubt we made much effort to collect. Statute of limitations in the Federal Government don't help. These statutes mean that if you don't collect the debt in a certain period of time, it gets written off, and the person doesn't owe anymore. I think that ought to be repealed, by the way.

I don't think we should have a statute of limitations like that. With over $345 billion in debt outstanding and $600 million outstanding in loan guarantees, the potential for even more delinquencies is enormous.

It is like a ticking time bomb. It is going to start coming due, and if we don't get the procedures to manage this stuff in place, instead of having $60 to $70 billion, it will be $80 or $90 billion in a couple of years.

And with the spending cuts being made because of Gramm-Rudman-Hollings, it just doesn't make any sense not to go after this uncollected revenue.

Fred Wolf and the other people at GAO are just super, and I think if the committee can use them as much as you can, they will be a tremendous help. They are one part of the bureaucracy that is willing to work to clean this mess up.

Based on the assistance of the GAO and research done by my staff, I found a number of things. First of all, there is no screening of participants in the loan programs. Virtually anybody that wants to get a loan can go in and get it. There is supposed to be a screening, but there really isn't any.

There is incompetent management of loan portfolios of those who have the ability to pay. So when we know somebody can pay, we don't really follow up to make sure they do.

There is insufficient use of private collection agencies and other means to assure collection from delinquent debtors; lack of resources dedicated to litigation efforts and enforcement of court judgments; lack of intergovernmental cooperation to obtain current debtor information and current accounting methods and systems.

It was back in the Carter administration when we first said we were going to clamp down. But we didn't get anywhere. We enacted the Debt Collection Act of 1982; we didn't make much progress there.

Mr. Chairman, one thing to keep in mind is that you are going to hear, "The administration has got everything in place they need."

I think administration officials are aware of this problem. They are going to be more aggressive. In May 1985, Dave Stockman put out a circular to everybody saying, "These are all the things you have to do."

When you look at it, it is going to surprise you, because it is going to look an awful lot like your legislation. But much of it has simply been ignored by the bureaucracies in this Government.

According to my discussions with the GAO staff, most Government agencies have inadequate personal accounting controls and, in many instances, there is very little information available on the status of debts and whether they are collectible. Without such a basic accounting framework, it is not surprising that a recent GAO study found that eleven agencies were reporting major problems in debt collection.

Collectively, these agencies administer about 92 percent of the Government's delinquent non-tax debts. Furthermore, although—and this is amazing—although conformity with the Comptroller General's accounting requirements was mandated by Congress 35 years ago, another GAO report discovered that Federal agencies indicated that 226 of 427 accounting systems, or 53 percent, were not in conformity with these standards.

So we passed a law 35 years ago, and 53 percent of it is being ignored.

In agencies, where appropriate, debt information could be provided, bureaucratic delays and lack of litigation resources have hampered collection efforts. Although the Debt Collection Act of 1982 took an important step by authorizing agencies to use private collection agencies, it took almost 3 years for the bureaucracy to write the necessary regulations to implement these provisions, and we only have four collection agencies right now.

I couldn't believe it when I heard it. It took them all this time to be able to develop a list of just a handful of collection agencies. Then they use the same collection agencies to track down cases in several bureaucracies.

It is not an easy job, Mr. Chairman, and that means money slides through the cracks in the floor. The Department of Justice has a backlog of 95,000 debt cases, and it has increased by 16,000 cases in the last year alone.

So you have got all these problems flowing into the Justice Department, which is the funnel to try to litigate these cases and the Justice Department doesn't have the staff.

In some cases, they are persuing other cases that are really more important. But sometimes they are just really not interested in debt litigation.

Due to the complexity of debt collection cases, and the multitude of problems involving current bureaucratic procedures, I am convinced that only a comprehensive response by Congress will dramatically improve collection efforts.

In my opinion, any solution to the delinquent debt problem must contain these following components.

No. 1, appointment of a debt czar who would be ultimately responsible for debt collection and credit management throughout the Federal Government. In other words put somebody in charge. That is the most important thing. Mandate all agencies to establish specific management systems to ensure proper and timely administration of credit assistance and debt collection. Require the adoption of current collection practices used in the private sector and the sale of debt portfolios to private investors or collection agencies.

Provide additional tools to the Justice Department and other agencies to ensure that debt collection efforts are enhanced by appropriate litigation efforts, enactment of new statutes that prohibit delinquent debtors from continuing to receive additional Federal assistance, provide budgetary incentives for Federal agencies to improve debt collection and facilitate the sharing of debt-related information between Government agencies to ensure timely collection.

I am very pleased that many of these conponents are included within title V of S. 2230.

I urge the committee to give these proposals very serious consideration. I am particularly supportive of provisions that require Federal agencies to use private collection agencies, establish debt collection targets for each agency and expand the ability of the IRS to provide taxpayer information to agencies pursuing debt collection activities.

The other positive measure within title V is the recognition that somebody must coordinate and supervise the Government's credit assistance and debt collection programs.

Mr. Chairman, I greatly appreciate you holding the hearing. I am glad we are going to hear from a number of people who clearly understand this problem. There is so much that can be done to improve things and so much that people in the bureaucracy want to do and so much that taxpayers in the country would like to see us do in order to improve our debt collection efforts.

We are not taking anything from anybody who hasn't taken something from somebody else. We ought to just make people pay their bills like most of the people in my district and in your State do, and I look forward to working with you in this subcommittee and the committee over in the House, to accomplish whatever we can.

I think we will lick the problem, but we are going to have to be really persistant and stay all over everybody involved.

Thank you, Mr. Chairman.

Chairman ROTH. Thank you, Representative Kasich.

I would just say that it is going to take some strong leadership, which you are exercising in this area. Too often, people try to ignore the problem, and in these days of budget problems, it seems to me that this idea is a natural, and I appreciate the strong leadership you are showing.

Representative KASICH. Thank you, Mr. Chairman.

Chairman ROTH. I understand, unfortunatley, that Representative DioGuardi is held up on a plane. I know the problem. But we do have Representative Boulter here.

Would he please come forward?

Because we have so much material to cover, I would ask you to summarize your statement, and, of course, all statements will be included in the record. But I am anxious to get through the heavy number of witnesses we have.

Mr. Boulter.

TESTIMONY OF HON. BEAU BOULTER, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF TEXAS,[1] AND HON. JOSEPH J. DioGUARDI, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF NEW YORK [2]

Representative BOULTER. Mr. Chairman, I do want to compliment you with my colleagues for calling this hearing and addressing the concept and more importantly, the need, Mr. Chairman, for improvement in the way our Federal Government makes its financial resources.

Certainly, I think your committee has no more important responsibility than oversight of the Office of Management and Budget, especially as we move into the area of Gramm-Rudman-Hollings. Our entire financial management system, and the budget itself, is going to be tested as never before.

I think Congressman Kasich's testimony points out what I see as the need for a chief financial officer for our country.

Congress is quite appropriately focusing upon the Federal deficit, debating the issue of whether to deal with that deficit by changing our spending habits, cutting spending or raising taxes, or a combination of both. But it is important to remember that there is another option.

There is another way to address the problem, and that is to improve the manner in which we manage the resources already at our disposal.

Congressman DioGuardi and I have introduced H.R. 4495 in the House, which establishes a chief financial officer for the United States within the Executive Office of the President.

It also establishes an Office of the Assistant Secretary for Financial Management within each executive department, as well as an Office of Comptroller within each executive agency, and it is toward that section of your bill, Mr. Chairman, that I would direct my comments in a summary fashion.

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[1] Representative Boulter's prepared statement may be found on p. 208.

[2] Representative DioGuardi's prepared statement may be found on p. 214.

We all know that Government is very big, a budget that is approximately $1 trillion, 2,000 different Federal programs run by 150 separate departments at 25,000 locations, administered by 2½ million civilian workers.

These facts were all outlined in the report by the Office of Management and Budget's "Reform '88" program.

But in that report, the OMB stated, and it is worthy of quoting here, that, "We do not really know the total cost of administration," which simply means, Mr. Chairman, we don't know the cost of doing business in this country.

The objective of financial management in the Federal Government should be, Mr. Chairman, to ensure that our financial resources and the real resources that they represent are acquired and used lawfully, efficiently and effectively to achieve constitutionally and legally consistent purposes.

As stated in the Joint Financial Management Improvement Program in the Federal Government of the United States, published in 1967, and I quote,

> Financial management is that part of total management which is concerned primarily with financial affairs of an organization and the translation of actions into meaningful and relevant information for use in the management process.
>
> Depending upon how an agency decides to set up its financial organization, management may encompass all or part of any specific function, such as programming, budgeting, accounting, reporting, cash management, control of resources, cost reduction, internal auditing, system developments and management analysis.

Mr. Chairman, in the 1970's, we saw the Bureau of the Budget reorganized into the Office of Management and Budget to place some emphasis and focus on management.

Since then, there have been several pieces of legislation, several reports, and I just wanted to mention one very briefly; that is the Grace Commission's report on Federal Management Systems. It highlighted what I believe is the most critical problem we have in the country today dealing with this problem, and that is simply the fact that there is not one single agency, not one department, not one single person who has any clear-cut and established authority or responsibility for developing and managing the financial management policy of this country.

As a result, no agency, department or person has been able to provide a continual, recognized and simple example of financial management and Federal leadership.

So we see the need for a strong and centralized direction in the management of our Nation's financial resources.

This need is very evident when you consider, Mr. Chairman, for example, that we have OMB, GAO, GSA, OPM, and Treasury all responsible for various and different aspects of financial management, with authority and responsibility disbursed throughout our country with no accountability, no continuity of any initiatives or directives which are aimed at improvement.

We have in the room today, and I know he will be testifying, Comptroller General Bowsher. But he cited the fact that billions of taxpayer dollars have been lost and mismanaged through the failure of our Government's 427 accounting systems to meet Federal requirements. That is nothing new, and I won't quote what he said about that, because it is in my testimony, and he is here himself.

But I would just point out that of the 428 accounting systems presently used by over Government's 18 different agencies, 226 of them have been cited by the GAO as not complying even with their own agency standards.

As Representative Kasich pointed out, these accounting systems have been in use for 35 years. For example, the Small Business Administration has reported that, taken as a whole, its accounting systems conform with Government requirements, and yet that agency has not even tested five of its eight different systems, through which 80 percent of its annual $2 billion budget is handled.

Mr. Chairman, these are the agencies that run our country; these are agencies that are under the jurisdiction of we Members of Congress. I could cite other examples that are contained in my testimony, but the point is that their financial management systems are ineffective; they are costly to the people we serve, the American taxpayer.

It is time for them to be improved and updated. Let me say in closing, Mr. Chairman, that I believe S. 2230, your Federal Management Reorganization and Cost Control Act of 1986, would be a very significant and necessary way to improve the management of this Nation's resources.

Judging from the situation which exists, it is my opinion that little can be accomplished through additional studies or special commissions, executive orders or any more OMB circulars. Although much has been done to address the problem, there is still a great deal of room for improvement, especially in these days of $200 billion deficits and total U.S. indebtedness of over $2 trillion.

Again, Mr. Chairman, I want to thank you for the opportunity to appear before you today. I look forward to working with you as we attempt to move toward a solution to this challenge.

Chairman ROTH. Thank you, Mr. Boulter.

We are delighted that you made it here, Mr. DioGuardi. I understand that you had some problems with the plane. I would ask, because of the very heavy schedule, that you keep within the 5-minute limit.

Your full statement will be, of course, included. Please proceed.

Representative DIOGUARDI. Good morning. Thank you. I want to commend you, Mr. Chairman, for holding these meetings. I have been anxious to comment in this area now for some time, since I got here in Congress.

I have slight allergies, so my voice may not be as good as it should be. But my background, as you probably know, Mr. Chairman, is I am a certified public accountant. I still am, even though I am a Congressman, a licensed C.P.A., and there are only four of us in the legislative branch.

When you look at 100 Senators and 435 House members, only four can claim the training that I have had for 22 years in a major accounting firm.

I think my experience working with the public sector as a professional has given me some insights that other legislators don't have.

In particular, I worked on the financial review that we did in New York City back in 1975 when Senator Proxmire was overseeing the financial results of the city in conjunction with the Financing Act, and there are many things that I have seen there and now that I think your bill is going a long way to address.

The bill that Congressman Bill Boulter and I have introduced on the House side, H.R. 4495, really deals with just the financial management aspects of your bill.

I am going to submit for the record my statement, Mr. Chairman, rather than read it. But I just wanted to comment on some of the more important elements of what financial management is all about and why it is important that we focus on this right away.

I have elevated the awareness levels of my colleagues in the House, and many times, out of frustration, they will come to me and say, "You know, Joe, maybe it is time that you put away those green eye shades," and my retort to them is, "Hey, I am not going to trade my green eye shades in for blinders."

I think what we have got around here many times are a lot of blinders. We are not doing the things we should be doing to bring in accountability, and that is the key word here, Mr. Chairman, accountability to the public. Is the public getting a dollar's worth of goods and services from a dollar's worth of taxes? From what I have seen, they are not.

We don't have to look too far. We have got the Grace Commission, Congressman Boulter's efforts in the House, and an informed Grace Caucus that is visible.

You now have the President's Commission on Defense Management, the so-called Packard Commission. You have seen the recent audits now that they have taken them out of the closet with NASA.

There are many, many examples as to why this body and Government is not being accountable to the public, and I think that has to change. There is a lack of common sense around here that is appalling, and it starts with the budget process that we have in the House and Senate.

Just sticking with that for a minute, because if we are going to provide leadership in this area, we have got to look at ourselves, when I look at the budget process here in the House and Senate, the only question that I see asked, Mr. Chairman, is, "What did we spend last year?"

That really isn't the key question. The question we should be asking is, "How did we spend it last year?" It is called zero-based budgeting in the private sector. You go back to the first dollar.

If you only ask whether we spent, what you are doing is you are institutionalizing spending. You should be conditioning everyone to spend what they are given in the budget. There are no incentives to save. That is the problem we have had here in Government.

I think there are four areas that we have got to attempt to address, and your bill and our bill, I think, begin that process:

No. 1, we have got to set accounting principles, accounting principles that are meaningful here in Government. We use a Mickey Mouse accounting system called a cash basis.

We told New York City to get off that system in 1974 as a condition for our help, and they even have a capital budget. They had one then. They have one now; we still don't have a capital budget, but we are still using a cash basis accounting system that is designed to disguise economic reality.

The books, when you deal with the annual deficit and the accumulated deficits, the annual debt, those numbers do not have $1 of liability: civil service pensions; military pensions; Social Security; accounts payable; contingencies; guarantees, they are all off the books, and yet someone is going to have to pay for those in the future.

That is the legacy we are leaving our kids, besides the $2 trillion debt, and it is a shame.

No. 2, uniformity, as Congressman Boulter said. The GAO has said that there are 427 accounting systems that we know of.

How can we share information and manage with that lack of uniformity and lack of common sense?

No. 3, compatibility of computers. To me, it is a crime that each agency can order a computer, order its own software, without having regard to what another agency's needs are so they can share that information.

One needs just to look at what the IRS did with its computer and the software and the debacle that we faced on that. This has got to change, compatibility of computers.

And finally, setting individual responsibility, a hallmark of financial management.

You can't fire anybody in Government; everyone blames the system. Look at what is happening with NASA. Now we have to truck out these 200-plus audits out of the closet because we had a disaster, and we still can't find someone to fire because we don't set individual responsibility.

So we need to centralize things underneath a chief financial officer, and he needs under him in each one of the agencies and departments an assistant secretary for financial management with a dotted line going to that individual and back to the Secretary so that we can begin to get information that we need, Mr. Chairman, in order to manage this Government.

I guess I will conclude on one other note, Mr. Chairman. That I have been here now for almost 2 years, and I have to say that I am not getting the financial information or the management information necessary to make the multibillion dollar decisions that I am expected to make as a House Member, as a Congressman.

How can I be accountable to the people who elected me when I am not getting that information, and yet we are running that Government right now without that information.

Again, I say that waste is not one big thing or two big things: waste is thousands of small things. It is structural; it is a study, and we need a chief financial officer, an independent chief financial officer with the appropriate accounting systems, compatible computers and individual responsibilities being set so we can find out what is going on here to be more accountable to the taxpayers.

I thank you very much for this opportunity, Mr. Chairman.

Chairman ROTH. Gentlemen, I thank both of you for being here. I wish we could get such enthusiasm for addressing this problem from more of our colleagues, both in the House and the Senate, because I agree with you as to its importance.

It seems to me, in order to meet the Gramm-Rudman-Hollings targets, a lot more could have been done in the area of management reform than we have been able to do so far.

I just have one quick question. You, of course, deal with financial management, and I agree with you as to the importance of that problem, but it does seem to me that there are the same kind of problems in other management areas, and you are singling out financial management.

I wonder if you gentlemen would agree with that?

Representative DIOGUARDI. I would. I think when you are talking about setting individual responsibility, it is not only with respect to financial management matters that it needs to be done. I think that you need management to be accountable to the goals of what they are being hired for, and I am not so sure that that is being done.

Accounting and financial management is one part of that, but setting management responsibility overall is another part of it, and I think that your bill is right in going in that direction, as well.

But I think that the crisis that we face right now starts with the foundation, which is the reporting and accounting mechanisms that we have here in Government to understand better what is happening.

Chairman ROTH. Mr. Boulter.

Representative BOULTER. Mr. Chairman, I agree with Congressman DioGuardi and you, and your bill. I think the primary need, though, as I am stressing and Congressman DioGuardi is, is that someone needs to be in charge of a good system, and right now, we have neither.

Chairman ROTH. Senator Eagleton.

Senator EAGLETON. I have no questions.

Chairman ROTH. Gentlemen, I thank you for taking the time to be with us this morning. Again, I want to applaud both of you for your strong leadership in an area where it is really difficult to interest our colleagues.

In closing, I would just say that one of the problems, when you were talking about New York City, is, we don't set good rules for ourselves. We say, "Don't do as we do; do as we say."

Thank you very much, gentlemen.

Representative DIOGUARDI. I look forward to working with you, Senator.

Chairman ROTH. We look forward to that. It is always a pleasure to welcome the Comptroller General of the United States, Mr. Bowsher. He is joined this morning by Fred Wolf, the Director of GAO's Accounting and Financial Management Division, and William J. Anderson, Director of the General Government Division.

Gentlemen, we are delighted to have all three of you here. Would you please proceed?

TESTIMONY OF CHARLES A. BOWSHER, COMPTROLLER GENERAL, U.S. GENERAL ACCOUNTING OFFICE;[1] ACCOMPANIED BY FREDERICK D. WOLF, DIRECTOR, ACCOUNTING AND FINANCIAL MANAGEMENT DIVISION, AND WILLIAM A. ANDERSON, DIRECTOR, GENERAL GOVERNMENT DIVISION

Mr. BOWSHER. Thank you very much, Mr. Chairman, and Senator Eagleton.

We are pleased to be here today to testify on the Federal Management Reorganization and Cost Control Act of 1986. This bill seeks to address significant management problems that have hampered the efficient and effective operation of Government for many years, and I share your concern that the management of Government programs and operations must be greatly improved.

Your bill seeks to upgrade attention to management by establishing a separate Office of Federal Management. I share your concern over the relatively ineffective management improvement efforts of the past decade or more and understand your desire to move the M out of OMB to provide the necessary focus on management.

We have studied centrally directed governmentwide management improvement programs conducted in the seventies and found that few of these initiatives had lasting impact.

Similarly, a panel of experts at the National Academy of Public Administration concluded in their 1983 report, "Revitalizing Federal Management" that the Government had experienced a decade of declining managerial effectiveness despite efforts to solve specific management problems.

They reported that improvement efforts had been sporadic, poorly planned, and inadequately backed and staffed.

I see no evidence that this has changed. We have reviewed several Federal agencies, and we have found need for improved systems along with some other things. Just to try to save some time, Mr. Chairman, I would like to summarize most of my statement here and insert the full statement in the record.

There is, in fact, one area that I would like to concentrate on: financial management. I think some of the witnesses before us here have very eloquently described what some of the problems are. For example, in the Debt Collection Act, if you don't have your receivable records and your accounting systems in good shape, it is very hard to maintain an effective debt collection system. When we look at the numbers over the last few years, as much as the administration has made a major effort, we see that the debts are increasing, and the amount of past due debts are also increasing.

So we are talking about real dollars here, and big ones, in the hundreds of billions of dollars. GAO has also done studies in the past about the lack of cost information. In one study, we pointed out that we couldn't even price our foreign military sales because of the lack of cost information.

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[1] See p. 216 for Mr. Bowsher's prepared statement. Two publications follow Mr. Bowsher's prepared statement: "Managing the Cost of Government—Building an Effective Financial Management Structure," Vol. I, Major Issues, February 1985, GAO, and "Federal Government Reporting Study," summary report, a joint study by the Office of the Auditor General of Canada and the U.S. General Accounting Office.

Recently, testifying before the House Armed Services Committee, I was a witness, along with the Comptroller's Office of the DOD, and the head of the Congressional Budget Office, Rudy Penner. The House Armed Services Committee was trying to find out how many billions of dollars were at Defense because of the inflation factors that had been put in the DOD budget. None of us could give them the answer.

In other words, basic questions that should have been answerable from the DOD accounting systems were not answerable simply, as we pointed out, because the budget and the accounting systems are not on the same basis.

You have full funding concepts over there, which literally gather up the money each year in full funding of appropriations for large weapons systems. Except for one or two appropriations, DOD cannot account for them, by major weapons systems, as to where they stand.

So, again, we are talking about billions of dollars which are very difficult for the executive branch to properly manage and, certainly, extremely difficult for the Members of Congress to know what the real situation is.

As I pointed out many times, GAO is not alone in recognizing these problems. This committee, along with the House Government Operations Committee, sponsored a bill a few years ago called the Federal Managers Financial Integrity Act. In that act, which I think was a superb piece of legislation, the managers of former agencies have to say, on an annual basis, where they stand on their internal controls and their accounting systems.

In last year's report, as well as in the previous year's report, all 18 departments and agencies which we reviewed—comprising over 90 percent of the dollars in the Federal Government—reported that financial management was a major weakness.

In reading GAO's Financial Integrity Act's reports, it is also particularly noteworthy that over half of the Government's accounting systems, covering about $700 billion, or about 70 percent of the $1 trillion in fiscal 1985, still do not conform to our accounting standards.

So this whole financial management area is an issue that has been with us for a long time, and it is one that we do not seem to be getting corrected. That is why I think legislation such as your committee is putting forth here should be given a great deal of serious consideration.

No one disputes what is needed here. Everybody agrees that we need complete, consistent, and timely and reliable financial information. But the big question is, Are you willing to put forth the effort to achieve it, and are you willing to have accountability?

As Congressman DioGuardi pointed out here a minute ago, you have got to have accountability if you are going to get this job done. What we have had is a mixed responsibility in accounting and accountability throughout the executive branch; even we play kind of a mixed role. I think that it is time to get the financial side organized and get it working to the point that we have adequate systems, adequate financial reports, and we know where our costs are.

I am especially anxious to see if we can get agency financial statements. In other words, we often try to solve these problems with some big, global OMB circular or legislation that doesn't really focus on what I think is important, and that is to get our larger agencies working right and well with adequate systems and accountability.

Another point I would just like to make is that the audit function is a key ingredient of having integrity in your numbers. I think unfortunate events here in the last couple of years with the Farm Credit System is a case in point. When you don't have audits for a number of years, you can see a large organization getting into trouble, and then it takes a bailout by the Federal Government, lots of times, to solve those kinds of problems.

We would hope that we do not have to have too many of those kinds of situations before everybody in the Federal Government understands the importance of having an annual audit of all these billions of dollars that go through our various systems. An independent review would tell, at the end of the year, how things stand.

Some of the opponents of this kind of an effort will say, "All they are trying to do is put in business style financial statements." We are not trying to do that. We are advocating a strong financial reporting and financial management system for each of the agencies on Government accounting standards. What we hope to have are financial reports that are absolutely appropriate for Government operation.

We have a GASB convened today that we support and that the Congress supported with some money. This is a fine board; they are setting standards for the State and local governments, and we plan to use a lot of their material in setting the standards for the Federal Government.

I think we can have the unique kind of reports that we need in the Government to know where we stand.

Mr. Chairman, these are the major points that I would like to make. I would just like to say that fairly recently, I had met with some of the senior financial people of Australia. They were describing their system to me. It is a centralized system that they put in some years ago.

They can all work off the same information whether they are in the Parliament, in the Defense Department, or in the Ministry of Finance. By doing so, they avoid the problems we face when everybody works off a different system.

I think that the U.S. Government, which for years was a leader in financial nanagement, should make the investment and get back into that leadership role, to help the Congress know where things stand and to help the managers in the executive branch manage these large Government programs.

Mr. Chairman, Senator Eagleton, we would be pleased to answer any questions you might have.

Chairman Roth. Mr. Bowsher, I want to thank you for being here today and for the role that you and your staff have played in this entire area of financial management.

I want to express publicly, my very great appreciation for the many people on your staff that have played such a major role in the work you have been doing in this area and in developing the legislation we are considering today. The quality of the work and the degree of cooperation have been excellent, and I do appreciate that.

Mr. **Bowsher**. Thank you, Mr. Chairman.

Chairman **Roth**. As you know, the broad purpose of our legislation, S. 2230, is to reach the objectives that we have been discussing for financial management: The Governmentwide implementation of modern accounting and internal control systems, the preparation of auditable financial statements by the agencies, and implementation of efficient cash management procedures. I could go on and on.

Let me ask you: Do you think that our legislation is achieving the kind of goal we have set out for financial management?

Mr. **Bowsher**. I think it is, Mr. Chairman. In other words, I think, organizationally, you can do it one or two or three different ways, but I think it is awfully important to get the responsibility away from OMB, because it just hasn't been working over there.

I think setting up an Office of Federal Management is certainly one viable way of looking at it or going about it, and I think our people might want to meet with your staff on a few areas.

But on balance, I think you have got legislation here that goes a long way to solving the problems that everybody is discussing today.

Chairman **Roth**. Looking at, specifically, title II through title VI, which deal more with procedures and methods and organization, are you generally supportive of those proposals?

Mr. **Bowsher**. Yes. Yes, very much so.

Chairman **Roth**. Moving to title I, your statement mentions concerns about a number of problems that are located at the agency level. In your view, is the establishment of a system of agency comptrollers for the largest agencies a necessary step in addressing the problems we have identified?

Mr. **Bowsher**. Yes; I think it is a very key part of solving the problem, Mr. Chairman. As Senator Eagleton knows, when we got up there to New York City, in the midseventies, we couldn't figure out head or tails of their financial situation. As Congressman DioGuardi pointed out, at the insistence of both the State and the Federal Government, we insisted on a new financial reporting system. We had that in place and working within a matter of months, bringing down the information to the Treasury Department.

They, then, went into a major program to improve their central accounting system and were able to do it within about 18 months, or 24 months, and just made marvelous progress.

That system today is working. I checked on it last year for the first time in 10 years, and it is just amazing how much better you can run a government when you have that kind of financial management system and information.

But in the Federal Government, we are just too large. We have to concentrate, I think, on the major agencies. As we have reviewed the Financial Integrity Act reports, we have concentrated on these 20 largest agencies where 90 percent of the dollars are.

I think if we could get proper systems in these agencies, we would have a much more efficient operation. In other words, we wouldn't have these 450—and I think that is probably an understated number—diverse accounting systems. We could summarize the information and know where we stand, and I think we have to do it at the agency level.

In other words, we can't do it in the Federal Government, because we are too large for just one big, central system.

Chairman ROTH. What about at the central agency level? We are all keenly aware of the 35-year history since passage of the Accounting and Auditing Act.

What are the major reasons for the current state of disrepair of our financial management systems? Particularly, what impediments have slowed or stymied us, and how can we overcome these problems?

Mr. BOWSHER. I think what we have is a 1950 solution which was appropriate at the time because of the limitation of data processing equipment at the time.

You really had to go to a completely decentralized accounting system. Over the years, all of these systems have been kind of upgraded at one time or another, but never with an overall conceptual framework from a central agency.

In other words, there were circulars sent out and things like that; but we never had a modern system with modern computers that could assist in financial reporting and produce agency information on a decentralized basis for the agency management. I think that the central accountability and authority has been missing. It has been spread among too many people. That is why I strongly support what many people are advocating here, and your bill certainly speaks to it.

Chairman ROTH. Where would be the most effective location for such a system?

Mr. BOWSHER. That is one that I vacillate from time to time on, as all my people know. I think Treasury could do the job, I really do, if they would ever step out and do it. But some of the people from NAPA the other day were trying to tell me that Treasury can't give orders to the other Feds.

In other words, one Cabinet officer in his department can't tell the other Cabinet officers how to do it.

If that is true, maybe setting up policy in an Office of Federal Management, like your bill is proposing makes some sense. If they set the policy right and have the agency part that your bill calls for, then maybe we can get the job done that way.

The one thing I have become convinced of is that it will never get done at OMB. The original concept was to tie management improvement to the budget, and it just hasn't worked. What we have really seen over the years is the budget people literally attacking the efforts to improve many of the management efforts and the financial management. It was just the opposite of what the people who put the OMB concept together wanted, and many of us at the time thought it was a good concept.

But as we have watched it work, we have becone more and more discouraged. I know some of your witnesses later in the day, who were strong supporters of the original OMB idea, will agree.

Chairman ROTH. That was actually going to be my next question. I have to say that I have seen nothing that gives me any assurance that OMB will be able to carry out the kind of reforms we are discussing.

So I agree very much with what you have had to say. Let me point out, if we do create a separate policy office for financial management somewhere outside of OMB, wouldn't such an office be cut off from other management functions, information resources, records management, procurement, human resources, organizational policy, productivity, et cetera?

In other words, does it make a lot of sense, organizationally, to have those grouped together under a common roof?

Mr. BOWSHER. You can certainly make the case for that, Mr. Chairman, and I know your staff believes that. I think that is very possible, maybe the best way to go. At the same tine, in many other organizations, both in Government and in the private sector, lots of times you will find financial management as kind of a separate function—a scorekeeping function. An author by the name of Townsend, some years back, described it well by saying you never have the perfect accounting system, but by God, get one, stick with it, make sure the information is consistent, and make sure that the scorekeeper and the other people that can get to it don't change the numbers.

That is what you are really trying to do here in financial management, so that is why it is sometimes separate from the other management aspects.

Which is best, I am not quite sure. But I think that either one would be better than what we have had.

Chairman ROTH. My last question is with respect to the authority of the financial manager. One of my concerns has been, as I have sat in this committee down through the years and talked about the various agencies, putting into operation the kind of accounting system that GAO has recommended; in many cases, nothing happens; it is just ignored.

How do we ensure, even if we create a new agency, whether it is an Office of Management, as I have proposed, or something else, how do we ensure that the agencies will follow through?

Mr. BOWSHER. That is tough to assure without leadership from the White House, and the leadership of any existing administration. In other words, when the accounting left us, we kept the books up until World War II as the General Accounting Office. That is what Congress was trying to achieve when it created us.

But when the Government got so large in World War II and stayed large after World War II, the decision was made to ask the executive branch to do the accounting and to issue the financial information and to have us be the auditors. I think that made sense.

But it is incumbent upon the people who are running each administration to want to have the right numbers and to be willing to share the numbers with the Congress. Unless you have that, legislation passed will just get stonewalled or will not get implemented by the executive branch, as we have often seen over the years, and that is always unfortunate.

So when you pass legislation, I don't think there is absolute guarantee that it is going to be implemented well. But I do believe this: That our study here a couple of years ago did indicate that if you are going to have a major management improvement in some area, lots of times a statutory base is a factor that has contributed greatly to getting the job done, because the Congress is saying to the executive branch, "We want this done; we want it done well." And that is why I think some legislation, such as what your committee is considering here, makes a lot of sense.

Chairman **Roth**. Let me ask you this final question: What if we provided that, in certain limited ways, if an agency doesn't implement prescribed accounting procedures within so many years, that someone else in the executive branch would have the authority to go in and implement them?

What bothers me is that I have seen, for years, and I don't care whether it has been a Republican or a Democratic administration, that these things have been ignored, and I think sometimes the bureaucracy just figures, "If we don't do it, these people are going to move on anyway in a few years."

Do we need to give that kind of authority to somebody? Somehow, whether it is the Department of Defense or HHS, I don't care if it is some major agency, they have got to be forced to comply. In a corporation—and we are not dealing with a corporation, of course—there is no question that the agencies, or the branches, have to comply.

Do we need to give some kind of authority somewhere within the executive branch to make sure that ultimately these management provisions are implemented, or can we do it by persuasion?

Mr. **Bowsher**. I am not sure, Mr. Chairman. We will give some thought to this issue and work with your staff on what some of the alternatives might be to have some incentives which are more than just persuasion.

Right now, I don't have a quick answer on that, but we would be willing to look at it very seriously. There is no question that the issues that you have raised pose a real problem.

Chairman **Roth**. We have some provisions in title II, and I would later like to work with you on that, because I think this is something that is critically important if we are really going to make any major changes.

Senator Eagleton.

Senator **Eagleton**. Thank you, Mr. Chairman.

I think your last line of questioning with Mr. Bowsher gets to the essence of the problem: You can put boxes all over the place, separate boxes out of one place and put it somewhere else, but unless there is clout, the box separate out by itself just won't fly.

Let me pursue this line of questioning with you, Mr. Bowsher, because you used to be Comptroller of the Navy——

Mr. **Bowsher**. That is right.

Senator **Eagleton** [continuing]. In one of your previous incarnations. Let's get this clear for the record. You do support splitting M out of OMB; you are not here endorsing every refinement and detail and period and comma of Senator Roth's bill. You want M out of OMB; right?

Mr. **Bowsher**. Yes.

Senator **Eagleton**. It has got to go.

Mr. **Bowsher**. I think it is the only way we are going to get the management improvements and the financial management.

Senator **Eagleton**. You are back there as comptroller at Defense. Mr. Weinberger is Secretary of Defense. The Roth bill passes. Professor Jones, professor of management and finance of Harvard Business School, is appointed Director of Management or whatever the title is. He calls up Weinberger and you are sitting there with him. He says:

> Mr. Secretary of Defense, I am this new Director of the Office of Management.
>
> Oh, yes. What is that?
>
> Well, I'm the guy that is supposed to redo all your books and records and your accounting systems and bring them all up to snuff.
>
> Yeah?
>
> I would like to send over some of my fellows to show you how your books are all screwed up, and I would like to go over and tell you and Bowsher how to keep your books, because we want to know about cost overruns; we can follow those a lot better if the books are right. We can follow waste and all kinds of things a lot better if the books are right, et cetera.
>
> We can do a lot better job of monitoring you, policing you, if your books are right.
>
> Um-hum.

So later this afternoon, Secretary Weinberger calls the President and says:

> Mr. President, you know, you have got a nutty professor over there—[Laughter.]—at the Office of Management. He wants to come over and throw the whole Defense Department into total turmoil. We have got national security at stake; we may have to bomb Libya or something like that, and we haven't got time to be fooling around with these nitpicking bookkeepers that drive us crazy, and all they will ever want to do, Mr. President, is cut, cut, cut Defense. If they do that, they will cut, cut, cut security. So would you please call that professor or have one of your guys call the professor and get him off our ass? [Laughter.]

And that is the last of him; it is bye-bye Professor Jones of Harvard Business School as far as that department is concerned.

Now, if you are calling Ray Donovan over at the Department of Labor, who had no political clout with the administration when he was here, you might be able to nitpick a little bit around with his books at the fringes.

Government runs by clout. That is how it runs, by clout. So splitting M out of OMB doesn't, per se, give M any clout.

You can write into the law "M will have clout. It has power." It can implore; it can urge; indeed, it can mandate changes, but if the Department of Defense doesn't want to do it, it won't be done, and you can't see the Professor suing Caspar Weinberger to get his books and records in shape. That is point one.

Point two, M, as part of OMB, poorly functioning as it is, let's make it atrociously functioning as it is, if that is right, at least is part of clout. Linked with B, it has some clout, if it wishes to exercise it, budgetary clout.

Now, query how cloutful a particular Director of OMB may be at any given time. Jimmy Carter, Bert Lance presumably had some clout. Who was the next guy?

Mr. **Bowsher**. Jim McIntyre.

Senator **Eagleton**. McIntyre, he didn't have much clout. At one time Mr. Stockman had some clout; then he didn't have clout.

Miller is now in a quest for clout. [Laughter.]

But at least M with B potentially would have some clout, because B can cut some numbers and B is going to say, "Look, I am going to cut your numbers," a billion and whatever it is, some item "unless you go along with our financial reporting reforms."

They haven't done it; they may never do it, but I am just wondering if you split M off by itself, if you aren't really creating a pathetic agency, an impotent, pathetic agency that can't function.

What do you think about all that? [Laughter.]

In a word or two? [Laughter.]

Mr. **Bowsher**. A word or two? [Laughter.]

Let me say that you describe exactly why M was created over at OMB, and that was the theory, that they would have clout and that they would insist on good information. If they didn't get good information, they would cut the budget.

What we have really seen is that no matter who is the head of OMB, it is generally the professional staff that gets down to deep levels of management systems and accounting systems and everything like that, and there is one big struggle that is going on here, and I have seen it in other governments, too.

In fact, I saw it after the New York City fiscal crisis, and that is, the budget people don't want a competing system, in other words they don't want a scorecard at the end of the fiscal year; they don't want accountability.

So any time that you start to have a financial management improvement program that starts to get to that scorecard system at the end of the year, a financial report, they sabotage it.

I can remember, as you pointed out, I was a young assistant secretary in the Navy Department. I saw the problems in the Navy system that I see today, and they are still there. I went to the Secretary of the Navy, John Chaffe, who is now a member of the Senate, and John Warner, who was undersecretary, and I pointed this out, and we got a program going. The wiser heads told me the only way I could keep that program going was to make sure that I got the assistant secretary of Defense and comptroller in charge of the budget people up there to make sure that the budget people didn't take the money out to try to get that system improved.

I did that, and we protected it. But just as you, Mr. Chairman, pointed out here awhile back, they outwaited me. I left at the end of 4 years, and 2 years later, or 3 years later, the program disappeared.

It wasn't the political appointees that killed that program, it was the career budget people, and that is what is happening here.

David Stockman fed the Congress a lot of cooked numbers, as he readily admits now in his book, and what they want to preserve over there is the ability to continue to do that.

I always remember when I went up to New York State at the invitation of the Secretary of Treasury to review New York State, just as we had reviewed New York City. The budget officer met me and said:

> Mr. Bowsher, I hope you are not bringing any new fandangled ideas like a better accounting system or an accrual basis or anything like that, because it would take away the flexibility of the governor.

He wasn't worried about the Governor's flexiblity; he was worrying about his own flexibility, and Governor Carey, who sat at the head of the conference table solving the New York City fiscal crisis, knew that his auditor, Mr. Levitt, who had been in office for years and who had been arguing for a fair and honest system for the State, knew that if he didn't put it in, he was going to be making lots of decisions on bad information. So he insisted on it, and they got it in 2 years or something like that.

I say that the management part, you are absolutely right, could be out there without any clout. But if Congress would insist on that clout, coming forward with a conceptual design of a new reporting system; if it would hold annual hearings as to what progress is made; if we have this agency comptroller and financial management person with a dotted line, at least, up to the central financial person—then the Congress starts to have a fabric of organization in the executive branch that should be coming up with the right numbers for you people to make the tough decisions.

So, getting back to the point that you raised—without clout, you are not going to get the job done—I couldn't agree with you more, Senator, and we have to figure out how to put the clout into the equation, I think.

Senator EAGLETON. That was the last part of the interrogation by Senator Roth of you, and Senator Roth started to press you about power and clout. You said you wanted to give that some thought. I don't want you to come and talk off the top of your head, but the Roth bill isn't worth a damn without enormous clout-like power going in the hands of this M guy—unless he has the power to demand and implement, even supercede, bring in 1,000 new bookkeepers to the Department of Defense, throw 1,000 of their guys on the street, whatever it takes, and I am just not picking on one department. It happened to be one that was mentioned earlier in the testimony.

Unless that happens, it isn't going to fly any better than it does as part of B. I think that is the real thing we have to worry about. One other reminiscence where you and I were both involved. You can recall when I was chairman of the most powerful Committee in the Senate, the Senate District of Columbia Committee. [Laughter.]

We operated out of a broom closet down the hall. [Laughter.]

The books and records of the District of Columbia were egregiously messed up; nobody could figure out what was what, even fine accountants such as yourself.

So we said, "Unless you fix those books and records up, we are going to start cutting back on your Federal payment." That was about it. We had to give it to them over their neck. So begrudgingly at first and then a bit more cooperatively later, they went along, and we redid the books and records.

The District of Columbia said we could make some sense about how much they were making and how much they were losing, the water system, water billing and the whole school board and the whole bit, a massive undertaking.

We finally got it in, and now, the District of Columbia, on a financial statement basis, can accurately reflect what their financial position is. But if we didn't do it by threat, it would never have been done.

Mr. BOWSHER. Yes.

Senator EAGLETON. So give it a lot of thought, as you said you would, and I know Senator Roth and his people will give it a lot of thought: How do we legislate that threat? I may be willing to go ahead if I know that this agency can really do the job, but if it is just going to be another agency floating out there with all kinds of nice presumed duties under these boxes and what-have-you, I don't think we will be a hell of a lot better off than we presently are, and we are not very well off as we presently are.

Thank you, Mr. Chairman.

Mr. BOWSHER. If I could just add one last thing to Senator Eagleton's point, and that is, that the leadership that he gave in that District of Columbia committee, I think, saved all kinds of bondholders millions of dollars.

In other words, one of the great problems, you remember, Senator, was that they wanted to sell bonds right away. You had sat on the New York Committee, and you got educated, and you took the leadership role here and really put a program in to get this system in. That had a big effect all over the country.

When we did the New York City thing in 1975, I did a quick survey of the rest of the largest cities, the 100 largest cities. None of them were audited. Very few of them had financial accounting systems and reports. Today they are all audited. With the single audit legislation that this committee has passed a year or so ago, why, the States are now all going to be audited.

So we have made trenendous progress at the State and the local levels of government in the last 10 years, I just got a book today on my desk from the Governor of Pennsylvania outlining how he wants the government of Pennsylvania to follow the single audit act, and that is a lot of progress.

Now we must figure out how to do it at the Federal Government level. That is really the big issue facing us.

Chairman ROTH. Because I strongly agree with what Tom Eagleton is saying, I would just like to say that whatever new approach we develop, clout is the answer. While I agree that Congress and the committee have had jurisdiction, that that can play a role, still, I think the first line should be within the executive branch itself. I would like to ask you two questions. We did provide, in our legislation, and I am not sure this is broad enough, this is just the first draft at it, but we said that if, 2 years after the effective date of this subsection, the administrator determines that an accounting or internal control system does not substantially comply with a requirement of this section, the accounting and other financial management operations of the agency which are supported by the system will be subject to the direction and supervision of the administrator for Financial Management to the extent considered necessary by the Administrator.

What we are, in effect, trying to say—I am not sure whether it is adequate or not—is that if they don't do it, if they don't comply, the agency, the Department of Defense or whatever it is doesn't comply, then it will be taken over.

Do you think that is an effective proposal?

Mr. BOWSHER. I think it is an effective proposal, except for the very largest agencies like Defense and, HHS. That is the one, I think, that we might have to give some more thought to because it isn't easy to take over those kinds of operations.

But I think for many of the agencies, that feature of it would be one of the more effective ways.

Chairman ROTH. Would it help to have that section in the White House so that it speaks for the President rather than a sister Cabinet member?

Mr. BOWSHER. I think it would. But I also think that the other possibility with a tenured position ought to be given some additional thought, too.

Chairman ROTH. Thank you, Mr. Bowsher, and Mr. Wolf. I think this is the nub of the question.

Mr. BOWSHER. It is.

Chairman ROTH. It is something that we have got to work on, so that whatever we do set up has the authority to do something about this situation, and that includes the very largest agencies.

Mr. BOWSHER. Thank you very much.

Chairman ROTH. Senator Durenberger has provided an opening statement which, if there is no objection, will be included.

[Senator Durenberger's opening statement follows:]

OPENING STATEMENT OF SENATOR DURENBERGER

Thank you Mr. Chairman, I would like to commend you for holding these hearings and tackling the extremely difficult issues which are involved in Federal management reform. At a time when the Federal budget deficit is forcing cuts in government programs and services, it is important that Congress consider ways to achieve cost saving through efficiency improvements and waste elimination. It makes little sense to slash the budget without taking measures to improve our management of scarce federal resources.

Reform legislation such as S. 2230 represents a step in the right direction. It strengthens the role of management as an integral part of the Executive Office of the President. It also implements a series of financial planning and control reforms which can help us to save billions of dollars in future years.

Since OMB's inception, the "M" in the office has been lost in the middle. The old budget agency is still driven by budget considerations. Management of federal programs and resources has taken a backseat to analysis of expenditures and revenues. Analysts charged with the task of making improvements in government agencies and programs have been armed with only one tool to do so: funding cuts.

The fact is that good management depends on more than dollars and cents. It depends on incentives and systems of accountability. It depends on good managers who are given the tools they need to do the job. In our system of government, it also depends on support within the Executive Office of the President.

The authors of S. 2230 recognized the importance of placing a voice for management in the President's office. They have called for the separation of OMB into separate offices; one responsible for the Federal budget, the other responsible for Federal management. There have been a number of other proposals for strengthening the role of management—each with particular strengths and weaknesses. I look forward to reviewing the hearing testimony on the idea of creating a separate Office of Federal Management. Such a novel proposal certainly deserves the careful attention of this committee.

S. 2230 also makes significant changes in government financial and accounting systems—changes which are long overdue. There are many hundreds of different financial control and accounting systems across Federal agencies. Through the Comptroller General has prescribed uniform accounting principles and standards, there remain a wide variety of agency accounting and internal control systems. To the extent that consistency among these systems will increase management capacity and efficiency, Federal agencies should be required to conform to a set of uniform practices and procedures of financial. S. 2230 recognizes the need for conformity and establishes and Office of Financial systems to achieve it.

As Chairman of the Intergovernmental Relations Subcommittee, I also compliment the Chairman on his treatment of management issues relating to cash transactions between the Federal government and the states. The Chairman's proposal is consistent with the memorandum of understanding agreed to by the Joint State/Federal Cash Management Reform Task Force. The system that has been devised takes advantage of electronic funds transfer technology to increase efficiency in cash transactions. This portion of S. 2230 is the result of joint efforts by Federal and state partners to fashion a reasonable cash management system. I am happy to see that the results of this partnership have been productive and that they are incorporated in this bill.

One area of S. 2230 may contain some potential problems. Title V, which deals with credit management, raises some issues of concern. In particular, the requirement that interest rates in new Federal loan programs be "comparable" to private sector market rates needs to be considered carefully. Federal loan program interest rates are lower than private rates because the Congress has decided to provide a subsidy to certain kinds of borowers. I am concerned that this bill would eliminate the ability of Coangress to provide that subsidy in the future.

I am also concerned about the proposal to assess loan origination and application fees. These fees are part of the subsidy congress has chosen to provide to some kinds of lenders. Again, I question the need for legislation which would prevent Congress from providing a similar subsidy in the future. I am also concerned that these fees might be assessed on new loans under existing programs. I believe this is an issue which should be carefully explored before this committee takes any action.

Finally, I am concern about the penalty provisions associated with agency debt collection targets. As the bill is drafted, debt collection targets would be set for each agency. If the targets are exceeded, an agency would receive 25 percent of the excess amount.

The problem comes if the target is not met. In that case, funding for the loan program in question would be reduced by the amount of the shortfall. The effect of this provision would be to penalize potential future loan recipients rather than those who are abusing the program. I do not believe we should make future borrowers bear the brunt of problems caused by other program beneficiaries. This provision also deserves careful committee scrutiny.

Again, I commend the Chairman on his foresight and tenacity in taking on such a complex set of issues. Management reform has the potential to achieve significant cost savings while at the same time improving the way in which the government is run. I look forward to the discussions and testimony we will hear on the bill today and to working with the Chairman to achieve true cost effective management reform.

Chairman ROTH. We are now very pleased to call forward the Director of the Congressional Budget Office, Rudolph G. Penner. As I understand, your testimony will be directed toward S. 2142, the so-called market plan approach to Federal credit management. It is always nice to have you here. Please proceed.

Senator EAGLETON. Mr. Chairman, might I interrupt you, because I am going to leave in a little bit. I know Mr. Penner is here for the credit portion of the testimony, but he is well known for his talent and skills and operation in the governmental process. I wonder if he could give us a reaction to this initial matter of splitting M out of OMB before we go into the other areas.

Chairman ROTH. And the question of clout?

Senator EAGLETON. And clout, and he has had to deal with clout.

Chairman ROTH. Mr. Penner, would you respond?

TESTIMONY OF RUDOLPH G. PENNER, DIRECTOR, CONGRESSIONAL BUDGET OFFICE [1]

Mr. PENNER. I don't consider myself an organizational management expert. I leave that mainly to the GAO. Certainly, my own experience working at OMB substantiates the conclusion that the M part has not been successful as it was originally envisioned. That is to say, it has, in fact, had very little to do with actual management matters. I don't want to imply that the people in that part are wasting their time. I think they have done useful work, but it has been far removed from management issues. To me, the issue of clout really goes mainly back to the White House, as I think the Comptroller General said.

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[1] Mr. Penner's prepared statement may be found on p. 292.

You really have to get them on board in this crusade in order to cajole the various agencies into cooperating with the kind of new financial management system that the Comptroller General envisioned. Obviously, the Congress, through various techniques, can impose enormous amounts of pressure on the Executive Office of the President to get involved. I think those pressures would very largely come through the authorization and the appropriations process. But as Mr. Bowsher said, unless you have that sort of leadership and persistence and a willingness to follow this through year after year, it will be very difficult to make it work.

Chairman ROTH. Please proceed with your statement.

Mr. PENNER. My testimony concerns the budgetary treatment of Federal credit programs. I will make three points in my statement: First, the current budgetary treatment of Federal credit assistance fails to depict accurately the costs to the Government of current activity. More precisely, current budgetary treatment focuses on the first-year financing costs rather than long-run subsidy costs. This makes budget accounting susceptible to manipulation.

Second, most observers agree that in order to capture the relevant costs and prevent manipulation of the budget numbers for credit assistance, subsidy costs should be substituted for program financing costs in the budget documents.

Third, several means exist to accomplish this change, and I shall note some of the advantages of each.

Page 2 of my testimony describes how, under current budgetary definitions, the difference in timing of different transactions can distort the true costs of direct loan and guarantee programs.

The inadequacies of using current financing requirements as a proxy for credit costs have been recognized for years. But the pressures to misstate true long-run governmental costs are greater now than before because of constraints imposed on the unified budget deficit by the Balanced Budget and Emergency Deficit Control Act of 1985.

Proposals have been offered recently, for example, to convert direct loans into equivalent guaranteed loans; to sell loans to private investors with recource and other types of guarantees; to switch borrowers with 100 percent Federal guarantees from the Federal Financing Bank [FFB] to private lenders; and to convert agency debt into agency "equity."

If individual credit programs were charged in the budget for the subsidy conveyed rather than for current financing requirements, the budget would permit comparisons between the real cost of credit and the cost of other forms of assistance, including grants. Moreover, such a change would transform the incentive to reduce first year financing requirements into an incentive to reduce true, long-term subsidy costs.

The subsidy cost of a credit transaction is the net long-term loss to the Government on the transaction. Suppose, for example, that the Government advances $100 in exchange for a promise to pay that amount. Suppose also that, because of the low interest rate charged and other factors, the loan has a private market value of only $65.

In that case, the loss or subsidy cost to the Government is $35. For guarantees, the actuarial value of insurance provided by the Government could be $100, for which the Government might charge no fee. If so, the subsidy cost is $100.

The market plan approach embodied in S. 2142 would preserve the comprehensiveness and cash basis of the unified budget and substitute subsidy cost for financing requirements by the competitive sale to the public, without recourse or guarantees, of newly originated loan assets. Such sales would produce a market valuation of the asset acquired by Government in exchange for a cash disbursement.

In addition, these sales would generate offsetting receipts, which, when netted from amounts disbursed, would yield an exact measure of both subsidy costs and Government financing requirements. All subsidies would be charged to credit agencies, which would require appropriations to finance them.

To address the understatement of guaranteed costs and avoid creating an incentive for the conversion of all direct loan programs into guarantees, S. 2142 could also require the reinsurance of all guarantees with private entities. By this means, the market plan would force the subsidy costs of guarantees to be financed. This option would work efficiently only if a competitive, private reinsurance market evolved quickly. To the extent that development is expected to lag, some phase-in may be necessary.

Moreover, a few areas may exist in which a market might not develop at all because private insurers may encounter considerable difficulty in identifying risks and in diversifying these risks. Similarly, active secondary markets are necessary to minimize interest costs for direct loans, and where these develop slowly, another reason exists for a phase-in period.

The Appropriations Plan approach is taken in the recently introduced S. 2428 and separates subsidy costs from first-year financing requirements. It would do so by consolidating all separate revolving funds into one central actuarily sound revolving fund for credit activities within the Department of Treasury. All direct loan disbursements and guarantee payments would be charged to this fund, and repayments and fees would be credited to this fund.

Existing credit agencies would continue to operate the credit programs, but they would be required to pay the subsidy costs of these activities to the central loan fund. As with the market plan, these subsidy cost payments would be shown in the budget as outlays to the credit agencies. The residual unsubsidized financing requirements would be charged to the revolving fund rather than to the credit agency.

A crucial element in the success of the appropriations plan will be the ability of the central loan fund to assess the value of various credit instruments accurately and at reasonable costs. The fund's staff would be greatly aided in this effort by the sale of some loans and the commercial reinsurance of some credit risks.

Over time, as acceptance increased, the loan fund might increase the proportions of loan assets sold and guarantees reinsured. In this manner, the appropriations plan could evolve into the market plan.

Thank you very much, Mr. Chairman.

Chairman **Roth**. Mr. Penner, have you or your staff made any analysis as yet of what is likely to be required to bring the documentation of current loan programs up to a standard that would facilitate the sale of new loans?

Mr. **Penner**. We have not, Mr. Chairman. We think that the legislation would, however, encourage the very precise description of the rights of lenders and borrowers, and that sort of precision would be necessary in order to encourage the development of secondary markets which, in turn, would significantly reduce the cost of the program.

Chairman **Roth**. Of the two plans you briefly reviewed, so-called market plan and the appropriation plan, which do you think is likely to more accurately and rapidly assess the true subsidy from all guaranteed loans?

Mr. **Penner**. As I pointed out in my testimony, sir, although the two plans are described in two very different pieces of legislation, probably as a practical matter, one should think of some combination of the two.

In the case of loans where the volume is high, where it would be easy to develop the secondary market and the reinsurance industry, then I think that, clearly, the sale of the loan to the marketplace would establish a reasonable value of the subsidy.

In some other cases, where secondary or reinsurance markets were not as perfect, an expert staff, working for this fund, might conceivably do a better job. But I think if you have the latter approach, you would want to make some sales to check on the accuracy of those staff estimates.

Chairman **Roth**. Let me go back a moment to the so-called market plan proposal. S. 2142 uses the Treasury Department as the marketing agent for those sales. Do you think this is feasible? Do you think they have the necessary expertise and experience to maximize the return to the Government?

Mr. **Penner**. There may be a necessity for a number of small additional staff and some training. But I think that through the Treasury's experience with the FFB, it has developed a lot of expertise in credit programs, and I think as a general rule, it can do a pretty good job of it.

Chairman **Roth**. My last question is, if we adopted S. 2142 in its present form, What amounts would we save in outlays in 1987 to 1991?

Mr. **Penner**. That is difficult to estimate before the budget is finalized for that year. But very roughly speaking, we think that there are about, at face value, $20 billion in loans that would be eligible for sale. Now, we don't include some things, like the foreign military credits and so on.

But excluding those, it would be about $20 billion. We speculate that the market value of those loans would be about $12 billion, so you would take in $12 billion that you would not have otherwise had.

If you had to go further and reinsure guarantees in the marketplace, that would probably cost about $6 billion, leaving a net gain of about $6 billion.

For the reasons I mentioned in my testimony, you might not want to do that all at once; you might want to do a third of it or half of it in order to see how the market reacts to these sales.

Chairman **Roth**. So that is roughly $20 billion in 1987?

Mr. **Penner**. No, I'm sorry, sir. That is just the face value.

Chairman **Roth**. Face value, yes, that is correct.

Mr. **Penner**. The market value would probably be about $12.

Chairman **Roth**. I didn't mean face value. The market value would be $12 billion. I wasn't quite clear. You said if we go ahead with the insured guarantee, that would do what?

Mr. **Penner**. You would have to pay private reinsurers to insure the new loan guarantees, and that would cost about $6 billion, according to our estimates. That reinsurance of guarantee isn't explicitly in the market plan legislation.

Chairman **Roth**. What impact would that have on the market value, then, any?

Mr. **Penner**. We are assuming the direct loans themselves would be sold without recourse. But if, at the side, the Government wanted to guarantee other private loans——

Chairman **Roth**. I see.

Mr. **Penner** [continuing]. And wanted to use the market there, that is not, however, in the legislation explicitly.

Chairman **Roth**. Right. We will probably want to do some additional work in this area, because, as I indicated earlier, we are interested in the market approach. We will call, if we may, upon you and your expertise for help in drafting those provisions.

Mr. **Penner**. We would be very pleased to provide it, sir.

Chairman **Roth**. Thank you, Mr. Penner.

I would like to call forward Mr. Connor, the chairman and senior partner in Price Waterhouse, and Mr. George Goldberger, who is the president-designate of Citizens Against Government Waste and a chief operating officer of the Grace Commission. I see that both of you have extensive statements. I am going to have to ask you to summarize those within 5 minutes each and we will, of course, want your full statements included in the record.

Mr. Connor, we would like to hear from you first.

TESTIMONY OF JOSEPH E. CONNOR, CHAIRMAN, PRICE WATERHOUSE,[1] ACCOMPANIED BY ED HALLER, PARTNER, PRICE WATERHOUSE; AND GEORGE S. GOLDBERGER, PRESIDENT-DESIGNATE, CITIZENS AGAINST GOVERNMENT WASTE,[2] ACCOMPANIED BY JOHN GROBOWSKI, DIRECTOR OF GOVERNMENT AFFAIRS, CAGW

Mr. **Connor**. Thank you, Senator. I am Joseph Connor. As you identified me, I am the chairman of the U.S. firm of Price Waterhouse. I am here today in association with George Goldberger and the Citizens Against Government Waste. I was a member of the Grace Commission and the cochairman of the Commission's Task Force on Federal Management Systems.

Also with me is my partner, Ed Haller, who worked on the financial management issues for the task force.

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[1] Mr. Connor's prepared statement may be found on p. 302.

[2] Mr. Goldberger's prepared statement may be found on p. 324.

It is not the first time our paths have crossed, Senator. I find you frequently in a leadership position on financial management issues. Now I think you have undertaken an initiative to develop legislation to address the crucial structural fault that we saw from the viewpoint of the Grace Commission.

I wholeheartedly support the overall management improvement objectives of your bill. At the same time, I believe that the bill in its current form falls short in achieving two fundamental objectives. First, appropriate integration of the Federal Government's currently fragmented and isolated financial and administrative management functions; and I think it falls short in the provision of adequate organizational stature and authority for the financial management functions so important to the clout that Senator Eagleton mentioned.

Let me talk about both of those. First, as to integration, there is a need for horizontal integration or the functional interrelationship, if you will, between the existing budgeting, financial management and other administrative management activities.

And second, there is a need to strengthen vertical integration by providing a clear delineation of management responsibilities within functional areas as reflected by the authorities and responsibilities that flow between the central agencies and the executive branch agencies.

The Grace Task Force found little effective integration of functional or organizational responsibilities. Instead, it found vertical and horizontal fragmentation. In order to provide for a functional integration of the Government's budgeting, financial management and other administrative management functions, the task force proposed the establishment of an Office of Federal Management with several attributes. They are shown on the chart.[1]

First, overall leadership and policy guidance would be provided by a director of the Office of Federal Management, reporting directly to the President. That is the top.

Second, the OFM would be composed of five functional organizational units with clearly defined responsibilities, which were: budgeting and planning, financial management, human resources, administrative services, and management improvement.

Third, each functional area would have a designated head, and fourth, the OFM would oversee GSA and OPM.

Well-defined functional responsibilities on a common organizational level, effective leadership with the authority to coordinate operations and decisionmaking and clearly defined working relationships with line agency counterparts—those were the key ingredients that Grace was trying to highlight.

The Office of Federal Management proposed in S. 2230, clearly lacks certain of these attributes. For the sake of brevity, let me provide some examples. Please refer to Exhibit B on page 20 of our statement, also on the chart.[2]

First, in the area of functional integration, the budgeting function has been completely detached from all other financial and administrative management components. Moreover, it resides on a different organizational level from the function with which it should have the closest association, financial management. That downplays clout.

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[1] See p. 321.
[2] See p. 322.

Second, in the area of organizational integration, not only has budgeting been functionally separated from all other management areas, but the bill has no explicit provision for interaction or consultation between the proposed Office of Financial Systems and the Office of Federal Budget on matters of common concern.

When the Federal Systems Task Force studied the organization and authority of financial management, it found two major deficiencies: One, financial management responsibilities were fragmented; two, financial management activities were not accorded the same organizational stature and authority as budget.

S. 2230 goes part of the way toward solving this problem; it attempts, not entirely successfully, to address fragmentation, but with respect to the proposed Office of Financial Systems and its leadership, as provided by the proposed Administrator, we believe that S. 2230 does not provide assurances that the following objectives necessary to allow an effective finance management function will be achieved:

First, organizational parity. By reducing the significance of the financial management function, as demonstrated by the uneven organizational relationship between the Office of Federal Budget and the Office of Financial Systems, S. 2230 encourages perpetuation of the current environment in which actual results of the operations and costs of managing the Government are not appropriately considered in the decisionmaking process.

Second, sustained and qualified leadership. The bill proposes a term of office for the Administrator of only 4 years, a period of time which is inadequate to implement the complex, long-term improvements required to achieve an acceptable level of financial management. Neither is the compensation level commensurate with responsibilities and challenges assigned to the Administrator of the Office of Financial Systems.

To correct these deficiencies, the term of office and compensation level accorded the Administrator position should be equivalent to those accorded to the Comptroller General of the United States, since we believe that the duties and the responsibilities of the two offices are common.

And third, compliance with management objectives. The absence of more than a budget review privilege accorded the Administrator precludes his ability to ensure that funds being expended by departments or agencies are in harmony with the Governmentwide financial management objectives and recognized agency requirements. This weakness can be corrected by granting the Administrator approval as well as advisory authority over agency financial management budgets, subject only to the subsequent concurrence of the Office of Federal Budget.

Mr. Chairman, I realize that in developing your proposal for the Office of Federal Management, you consulted with many sources; Grace was one of them. I would like to propose an alternative to some of the faults that I had stated a few minutes earlier. In order to address one objection, let me propose for your consideration an alternative organization plan for the budget financial management and administrative management functions.

While not a recommendation from the Grace Commission, I offer it on behalf of Price Waterhouse and in the spirit of cooperation and dedication to remedying a serious flaw that our firm sees in this. The Office of Federal Management was interposed between the line central management functions and the President because the five primary areas of functional activity were thought to create too wide a span of control for the President to directly accommodate.

By consolidating three of these activities into a single Office of Administrative Management, we could reduce that span of control.

Please refer to exhibit C on page 21, or the chart.[1] What results is an Office of the Federal Budget, an Office of Administrative Management, and an Office of Financial Management, each headed by a Director, all within the Executive Office of the President. For the sake of simplicity, we assigned responsibilities to each of these three offices along the lines proposed in the Grace model. But details in the assignment of responsibilities can, of course, be worked out.

The important result is that this alternative structure would accomplish several objectives: First, it removes the need for the intermediate level between all the principal management functions of the President.

Second, it places budgeting, administrative management, and financial management in a position of organizational parity; and third, it places ultimate responsibility for integration and coordination of these three functions at the highest possible level, the Chief Executive Officer.

Some have claimed that the wholesale reorganization of the Federal Government's budget and management functions, whatever form it may take, is too ambitious. They say it will never happen. So let me leave you with this thought from, actually, a long-term student and I hope constructive critic of Federal Government financial management. If nothing else is done in the management area, Congress and the executive branch should take the steps necessary to strengthen the financial management function and institutionalize it at the same organizational level as the budget function.

It is not only the right time to do it, but with Gramm-Rudman staring us in the face, it is long past due.

Mr. Chairman, that concludes my prepared statement. Again, I commend you and the members of this committee for the leadership that you are showing in seeking ways to bring sound management to the affairs of the Federal Government.

Chairman ROTH. Thank you, Mr. Connor.

Mr. Goldberger.

Mr. GOLDBERGER. Thank you, Mr. Chairman.

Thank you for the opportunity to appear before you today. Mr. Chairman, you and your staff are to be congratulated for the extensive work you have done on management reform and for producing a critically important piece of legislation.

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[1] See p. 323.

I am appearing today on behalf of Citizens Against Government Waste (CAGW), and with me is John V. Grobowski, our director of government affairs at CAGW. This organization is working to implement the recommendations of the President's Private Sector Survey on Cost Control, popularly known as the Grace Commission, and other proposals to reduce waste and inefficiency in Government spending.

My remarks this morning are taken from a longer statement which I would like to submit for the record.

As noted by Mr. Connor, Federal Government management reorganization is one of the most fundamental and vital initiatives to improve Government efficiency. Financial and information management efficiencies are responsible for much of the waste and inefficiency in our Federal Ggovernment's operating systems. They pervade every area of the Government. Without a proper framework and guidance, the federal system cannot determine how to properly allocate its resources.

Here, I would like to address some other aspects of S. 2230 and their relationship to the findings and recommendations of the Grace Commission.

Mr. Chairman, I am pleased to note that S. 2230 incorporates more than 30 recommendations made by three task forces of the Grace Commission.

These task forces found that fragmentation of administrative policymaking has caused a lack of high-level attention to significant opportunities for reducing Government costs. They found that independent information systems for payroll, accounting, and asset management in each department and agency is inefficient, costly, and counterproductive, and they found that it is extremely difficult to extract from existing systems timely and focused financial data including collection of debts owed the Government, location and utilization of real property inventories, and even identification of data processing systems currently used.

There is no central control over automated data processing systems, leading to expedient and temporary modifications rather than incorporation of technological advances in hardware and software. And finally, management of Government assets, capital planning, and cash management has been given a low priority.

Mr. Chairman, there are many provisions of S. 2230 that are consonant with Grace Commission recommendations. I would like to highlight a few of those. In the area of financial and cash management, both S. 2230 and the Grace Commission would establish comptrollers in the departments and agencies which would implement the policies and procedures of a centralized financial management office and would require agency compliance with General Accounting Office principles.

The central financial management office would review agency reports to determine compliance; it would require the departments and agencies to produce annual financial requirements in compliance with GAO standards, subject to audit; it would establish cash management criteria for timely disbursement of Federal funds; and it would assist them with rewards and penalties as incentives for improved cash management.

In the area of credit management, both S. 2230 and PPSS would require that interest rates for Government loans be comparable to market rates; loan origination and application fees cover administrative costs; and all loans include default, delinquency, and acceleration clauses.

In the area of debt collection, both S. 2230 and the Grace Commission would establish debt collection targets; a system of incentives and penalties to meet these targets; agency delinquency, default and debt standards, the use of private sector collection agencies; and the use of tax return information by agencies to help collect delinquent debt.

In the area of information management, both S. 2230 and the Grace Commission would establish senior agency information officials under the Director of an Office of Federal Management to coordinate the orderly development of Federal information systems and policy and enhance interagency sharing of information resources and reduction of paperwork burdens.

Mr. Chairman, I commend you for your initiative and dedication to improving the management of our Federal Government. This is a substantial undertaking and one which has far-reaching consequences. We cannot afford business as usual. That approach has led us down the path of huge deficits and a ballooning public debt. You have stated that your bill can save $4 billion over 5 years. Prevention of future waste and inefficiency through restructured and accountable management and financial systems will save billions more once the new systems are functioning effectively.

That is the end of my formal statement. I would be happy to answer questions.

Thank you.

Chairman ROTH. I want to thank both of you, Mr. Connor and Mr. Goldberger, and the groups you represent for the role that you are playing in trying to bring about the kind of reform that I think is essential if the Government is going to do a better job of providing the kind of services that it is intended to at a cost that can be borne by the taxpayer.

In talking about organization, there are always many ways you can skin the cat, so to speak. But the thing that concerns me is the fact that OMB, as it is presently constituted, is not working. This does not mean that they aren't doing some good work, because I think they are.

But it is not discharging the kind of responsibility that was anticipated when OMB was initially created. Is that a fair statement? Would you agree with that, Mr. Goldberger?

Mr. GOLDBERGER. I would. I think we found in the work of the Grace Commission that the emphasis is clearly on B and not on M.

To a considerable degree, OMB responds to what Congress asks them to respond to. They are asked about budget numbers, and they respond with budget numbers. But we have found, from our experience in the private sector, Mr. Chairman, that you need to first have a management structure and system in place to make those numbers meaningful.

Because the M is not in place, sometimes the numbers are not very good.

Chairman ROTH. I agree with your comment that OMB is budget-pushed or number-pushed or whatever you want to call it, in part, because of Congress. Essentially, I don't see that really changing. I also don't see management ever becoming the kind of proposition that a legislative body can deal with efficiently. Politically, it is not an exciting area; you are not going to get many television cameras to watch the proceedings. So that I think we have to recognize that as a fact. In trying to put together a package that we think will make for efficient management, I think we just have to recognize that this is the kind of problem that is not simple to understand or even to describe.

I was impressed by the Members, the several Congressmen and one Senator that came this morning who have taken an interest in this area, because it is rather difficult to deal with it in a legislative environment. As we proceed with our proposal, I would like to feel free to call upon you gentlemen and your staff for your advice and consultation.

I will state that a great deal of what has been done has come about due to the excellent work that you two have been involved in, and I want to express my appreciation to you and your organizations.

Thank you very much.

Mr. GOLDBERGER. Thank you.

Mr. CONNOR. Thank you, Senator.

Chairman ROTH. At this time, I am very pleased to call forward a panel of two organizations that have been close students of Federal management and organization, the Center for Excellence in Government and the National Academy of Public Administration. We are delighted to have representing the Center for Excellence, Christopher T. Cross, president and chief operating officer for the University Research Corp., and Edward G. Sanders, president and chief operating official of the International Planning Center, Inc. They are accompanied by Mr. Abramson, who is director of the Center for Excellence.

Ray Kline, president of the National Academy of Public Administration, and Alan Dean, who is the chairman of the Academy's standing panel on executive organization and management, will represent NAPA.

We are delighted to have you gentlemen here, and as I said, we will incorporate your statements in their entirety. But we would like you to proceed, if you would, Mr. Cross.

TESTIMONY OF CHRISTOPHER T. CROSS, PRESIDENT, UNIVERSITY RESEARCH CORP.,[1] AND EDWARD G. SANDERS, PRESIDENT, INTERNATIONAL PLANNING AND ANALYSIS CENTER,[1] BOTH REPRESENTING THE CENTER FOR EXCELLENCE IN GOVERNMENT, ACCOMPANIED BY MARK A. ABRAMSON DIRECTOR OF THE CENTER FOR EXCELLENCE IN GOVERNMENT; AND RAY KLINE, PRESIDENT, NATIONAL ACADEMY OF PUBLIC ADMINISTRATION,[2] ACCOMPANIED BY ALAN DEAN, CHAIR OF THE ACADEMY'S STANDING PANEL ON EXECUTIVE ORGANIZATION AND MANAGEMENT

Mr. Cross. Thank you, Senator. First, we would like to join with the others today who have commended you for the attention you are giving to the subject of excellence in the management of the Federal Government. The Center for Excellence in Government is composed of people who have been in the public sector, in management positions, and are now in the private sector. They continue to share a concern about the whole area of excellence in the management of Government. The center includes individuals who have held highranking positions in the executive and legislative branches. We share your concerns to improve management in the Government.

Our statement today addresses title I of the legislation. We do not take a position as a center on the legislation itself, but rather we raise some areas that we hope that you and the committee will give attention to as you proceed in considering S. 2230.

I think the sum and substance of our statement can be summarized by our belief that the committee needs to pay attention to the people part of the process of managing government. S. 2230, as it is now conceived, and the witnesses who have testified this morning, have dealt primarily with systems—financial systems, management systems, credit management systems and the like.

We would argue that the major problem that exists in Government today is that there is too much micromanagement. There is not enough incentive for managers to manage well. There are not the kinds of opportunities that exist to allow people to take risks and, indeed, to fail in Government. What you have to have is a situation where there is not a proper environment for management to take place. What that means, for example, is that in considering this whole weighty and very complex question of managing government, that you need to give special attention to the Office of Personnel Management and how the personnel functions relate to management.

You really need to design mechanisms to be sure that two things don't occur: One is that you do end up creating more micromanagement and more layers in the the Government; and second, that there are incentives in the system which allow good management to occur.

That means, for example, not having uniformity throughout the entire Government. We all know that the Government is composed of hundreds of different agencies and organizations, and unfortunately, the way that the laws have developed is that the same rules and regulations apply to everybody, no matter what their organization or agency. That needs to be changed.

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[1] See p. 338 for the combined prepared statement of Mr. Cross and Mr. Sanders.

[2] Mr. Kline's prepared statement may be found on p. 351.

Finally, we would add that we think the idea of more attention to management is important. We would suggest that that can be accomplished in a number of ways which are detailed in our statement. We feel that the idea of an Office of Federal Management can be either a positive or negative force.

Mr. Sanders also had some comments to make from his perspective and his experience.

Chairman Roth. Mr. Sanders.

Mr. Sanders. Mr. Chairman, I want to reinforce the theme of our statement. We believe that it is important for both the Congress and the President and the central management agencies to focus on the broadest aspects of management. My observations are based, in part, on 12 years as a career official on the budget side of OMB. In late 1979, I chaired a 6-month internal study for the then Budget Director on OMB's future roles and mission.

As a result of that experience, I came away convinced that OMB had not lived up to its potential on behalf of the President to reinforce the perspective of looking at the totality of Government programs and the impact of those programs on the overall incentive environment that encourages better public management.

I think it is all too easy for the OMB or the other central agencies to get caught up in fixing specific programs. They tend to lose sight of the need to assess the cumulative impact of all programs on the ability of Government managers and personnel to run their programs better.

So I think, as Chris has said, we are not taking a position as a center on the specific creation of the Office of Federal Management. Our concern is whether it is created or whether efforts are made to reinvigorate the management side of OMB—the charge has to be very clear from the Congress to those central management agencies that they keep their eye on the ball. His job should be to create an environment in which Federal programs can work better, not getting caught up in creating a series of additional rules, regulations, and organizational structures that I think all too often frustrate management and decrease flexibility and accountability.

We hope that the committee will be able to focus the attention of both the Congress and the executive branch on this very important series of questions.

Thank you.

Chairman Roth. Mr. Kline.

Mr. Kline. Mr. Chairman, it is our privilege and pleasure to appear before the committee today to present the views of a panel of the National Academy of Public Administration on S. 2230. While the bill contains many important proposals, I would like to concentrate my statement on title I, which would establish an Office of Federal Management.

How the Government operates has become a matter of critical national concern. The Reagan administration is on record countless times recounting the problems of Federal management and has undertaken an agenda of management initiatives, such as Reform '88 to deal with them. You already heard from the Grace Commission and a brief status report on their almost 2,500 recommendations for improvement.

Although many notable achievements have been made in recent years to improve Federal performance, the fact remains that much more needs to be done to set things right. As the committee has learned, there are many views on what to do.

Suggestions range all the way from the Grace Commission recommendation, which would create a private sector corporate-style headquarters to support the President as CEO of the executive branch, all the way to those who would attempt to fix things by shoring up the current structure.

In 1983, a panel of the Academy issued its report revitalizing Federal Management: Managers and Their Overburdened Systems, which describes the management problems now facing the Federal manager, and presented recommendations on what to do about them. Although recognizing a number of excellent administration-led management improvement efforts, the academy panel concluded that the present central management agency institutional base to sustain a high level of Government management, is too weak, and must be strengthened, and that the key to this lies in taking a look at the role of OMB.

The panel has strongly advocated the creation of an Office of Federal Management. Why did the national academy's panel feel so strongly that the OMB, which the academy helped to create, was no longer the answer? What were the primary considerations which led to this proposal for an independent Office of Federal Management?

Here are a few of the considerations that were involved: The importance of the Federal budget is such that it all but totally preoccupies the attention of OMB leadership, and this preoccupation is becoming greater. Management reform is never going to get the sustained attention and leadership it requires while it remains subservient to the Office of the Budget.

Even in the best of times, the total resources dedicated to management leadership at OMB have been inadequate to meet the demands of Government, and today, OMB finds itself falling even farther behind. This condition argues for a stronger, more energetic and more focused managerial organization of the type that S. 2230 proposes.

Even though budget examination often involves management issues, it is the panel's judgment that the existence of a new and more effective Office of Federal Management would provide substantially greater support to the budget review process as far as management improvement initiatives are concerned. The panel believes the OFM will provide a capability which will make the budget process more effective and valuable in the implementation of Presidential management initiatives.

True management improvement demands sustained attention and continuity of effort. All too often, what we have seen has been management improvement in fits and starts.

What was the legacy of the Carter Presidency's reorganization project? Will the next administration continue the initiatives of reform 88? What will happen to the implementation plan for the

Grace Commission recommendations? Management improvement must be effectively planned, directed, and implemented in consideration of the longer term and not in 4- or 8-year spurts. It is not enough to mount occasional narrow projects for improvement based on political expediency and ignore the wider range of Government activity.

An Office of Federal Management, with a strong, comprehensive congressional charter behind it, and dedicated, committed leadership within it, will certainly provide program breadth and continuity of effort far superior to that which has existed up to now.

Thus, the Academy strongly favors the creation of the OFM as defined in title I of S. 2230. But there is one specific change in the provision which I would like to address.

The Academy's Standing Panel on Executive Organization and Management, represented here by Alan Dean, notes that the legislation would statutorily provide for three elements of reorganization, the Office of Federal Procurement and Policy, and the Office of Regulatory Affairs, both already mandated by statute, and an Office of Financial Systems which would be created.

The panel has no quarrel that the OFM contain the function of these organizations. But the bill would place into OFM many additional functions of great importance, functions which do not fit into these three organizational elements, but which require strong organizational emphasis.

For example, intergovernmental relations; Government organizational structure; work force planning and management; and the large array of administration functions associated with managing the assets of Government.

Such a broad functional span suggests the need for flexibility in the management structure so that resources can be applied as needed. The panel strongly recommends that the legislation be drafted in such away that OFM authorities and responsibilities are vested in the OFM director—without locking specific subelements of the organization into statute.

This would assure accountability of the director of office to the President and to the Congress and at the same time provide management flexibility for OFM leadership to do what the office is charged to do. OFM would have a relatively small staff in relation to its responsibilities, and the director will need maximum flexibility in the use of that staff to meet current priority demands at any given time and to put the talent where the problems are.

Unless this change is made, the panel fears that a single coherent organization will not be created, but rather an ineffective grouping of four largely independent entities over which the OFM director would have no real authority and resulting in all of the conflict and inefficiency that such an arrangement invariably produces.

The panel favors a straightforward approach: Create the office; define its responsibilities, as S. 2230 does in law; and mandate their accomplishment. We believe this arrangement would provide for an OFM more responsive, not only to the President, but to the Congress, as well.

In the final analysis, the success of a properly constituted OFM will depend on the quality of its professional staff. There will have to be an appropriate blend of political and career executives to occupy the most senior positions to assure responsiveness to administration initiatives while at the same time providing continuity of efforts for ongoing programs and an institutional memory for what has gone before.

The professional staff will have to be larger, more senior, more generalist and more globally experienced than has been the case in recent years at the OMB. By background and by predilection, the staff will have to fit hand in glove with the role of OFM as a policy and planning organization which attends to problems at the broad management level and eschews intervention into the detailed operations of agency management.

In its revitalization report cited earlier, the Academy panel made a solid case for flexible, decentralized management systems, systems which let managers manage within the agency. One of the great pitfalls to be avoided at all costs is the OFM becoming another bureaucratic layer of centralized control with its strangulating effects on agency line management.

One of the questions most often asked of the academy panel is: Aren't you really advocating four central agencies, OFM, Budget, GSA and OPM?

Well, the academy panel believes that the proposed OFM should assume the management leadership responsibilities of OMB and should continue to serve as the single agency which can advise the President and on all Federal management matters.

It is the panel's view that there is no reason to believe that the new OFM would impair these other central management agencies, and each would continue to be fully responsible for its own policy areas as defined by the President and relevant statutes.

This concludes my statement, Mr. Chairman, and we would be happy to respond to any questions.

Chairman ROTH. I would like to start out by expressing my personal appreciation for the excellence of the work your group does and how helpful it has been to my staff and myself in not only these deliberations, but others, as well.

I have one question that goes back to a point raised earlier by me and expanded upon by Tom Eagleton, and that is the question of whatever the reorganization is, how do we give that organization the kind of clout that will enable it to function effectively? I think Tom very adroitly pointed out that we end up doing nothing if we just move a lot of boxes or create new ones but not provide them the kind of wherewithal that will enable them to function effectively.

Would you like to start out, Mr. Kline?

Mr. KLINE. Yes, sir. I will ask Alan Dean, who chaired our panel, to say a few words, and then I might have a comment of my own.

Mr. DEAN. Mr. Chairman, I think Senator Eagleton raised a very central point. When the academy's panel that recommended the Office of Federal Management was conducting its deliberations, it is interesting to note that of the nine members, five were former OMB or Bureau of Budget officials. Some were assistant directors. A few years before, they would have all favored the retention of the M functions in OMB on the grounds of the clout provided by the budget.

By the time the revitalization of Federal management study was made in 1983, these former officials unanimously concluded, as Chuck Bowsher indicated earlier, that not only was the juxtaposition in OMB not providing clout, but was actually weakening the management improvement function in two ways. First, by involving it unduly in the budget process, emphasis tends to be on short-term savings. Second, because of the priority given to the budget, it has driven out the staff resources required for effective leadership in the management area.

It is now clear that we are never going to be able to place in an executive office element the authority to order around Cabinet officers in the absence of Presidential support and congressional encouragement. But one thing is very important about the concept of the Office of Federal Management which will tend to make it effective. It must be seen as an adequately funded entity with a stable staff, professional in quality, respected by the Congress and the agencies, which can develop and direct over a period of years a consistent and strong program of management leadership.

I have been an agency official for many years and I know that most agencies don't try to run their programs poorly. Secretaries aren't trying to manage badly. If they have a center of informed leadership and assistance in the executive office, they will tend to draw upon it.

I do not think that a scenario in the director of this office is seen as running around giving orders to Cabinet officers is the way to be effective. An offer of Federal management should exercise its influence by advising the President on what constitutes good management; by advising congressional committees, such as this one, as to what constitutes good management, and by giving genuine help to the executive leadership of the agencies and departments.

Chairman ROTH. Mr. Kline?

Mr. KLINE. Sir, I would also like to comment from a personal standpoint. About a year ago, I was running General Services Administration in an acting capacity for a year, between appointments of permanent administrators. During the last 5 years, I worked directly with the Cabinet Council system on various Governmentwide initiatives. I would like to underline the point made by Mr. Dean in line with my own experiences, that the need for Presidential support, regardless of how the charter reads, is absolutely indispensable. For the various initiatives Governmentwide we at GSA were asked to participate in, and in some cases direct, the presentations were made to the President who then made the decisions. It was the President acting in the context of the Executive orders and directives to agencies that provided the clout for many of the things getting done.

I think to have the OFM envisioned as a group of management analysts in the sky which is just going to advise on this, that and the other thing is doomed to failure without the kind of active support that must come from the Oval Office itself.

I think the policy role of the office has to be expressed in the broadest sense, and I think that there are mechanisms that can give the office clout it needs—an authoritative role in the creation of Executive orders, a role in legislative review and the kind of followup required to make sure things are done—roles which provide the kind of teeth that can give the office some real meaning as to what it is being charged to do.

But underlining it all would be consistent support from the President in making the office work.

Chairman **Roth**. I have just one comment. I am somewhat of the school that one administration never learns from another irrespective of whether they are the same political party or not. What bothers me about relying upon the President, and I think basically I agree with that, but the fact is that every time there is a change in administration, it takes a long time before they catch up with this kind of nonpolitical problem. And for that reason, you can lose a lot of momentum.

Mr. Cross, would you care to comment any further?

Mr. **Cross**. Well, not taking issue at all with what Mr. Dean and Mr. Kline have said, my concern would be that if you segregate the budget side from the management side, you need to retain some connection. I have seen, as I think all of us in this room probably have, instances where the management side was trying to accomplish something and yet the resources weren't there to do it, and the budget side undercut the management perspective of the management initiative. There has to be some way to make sure that there is followthrough.

I think even today, in an organization where they share the same roof, that is one of the biggest problems. The one side of the organization hasn't talked to the other, and there is no way to enforce discipline. If you segregate planning from budget, that may make it even worse.

I would also add that the importance of the personnel authority is, I think, as important as anything we could talk about here in terms of carrying out effective management.

Mr. **Sanders**. I would even make the point more strongly. I think what we found in the study that I mentioned before, that all too often, and having been guilty of it, I recognize it, that the budget side really paid very little attention to the management side and even created reverse incentives for better management. To state it a little better, if agency management incurred the bureaucratic costs of finding a better, cheaper way to do a better job, usually we cut their budget. That is the primary incentive that bears on a lot of program managers.

I think the risk is very clearly on the negative side. If the Office of Federal Management is created, it will be all the more difficult to try to force that broader, sort of wholistic view on all of the central management group, but particularly, the budget side of OMB, since the Federal budget, from my perspective, is probably the strongest incentive device that can be used on individuals, and particularly, program managers.

Chairman **Roth**. Do you have anything further?

Mr. **Abramson**. No.

Chairman **Roth**. Gentlemen, unfortunately, I have to leave. We do have a number of additional questions. I think maybe, with your concurrence, what we would like to do is submit these questions to you in writing. A number of them are quite technical, and I will get the value of your advice in that measure. Again, I appreciate very, very much your being here, and as I said, I look forward to continuing to work with you not only in this area, but other proposals, as well.

Thank you very much.

Mr. CROSS. Thank you, Senator.

Chairman ROTH. The committee is in recess until 2:30.

[Whereupon, at 12:15 p.m., the committee recessed, to reconvene at 2:47 p.m. the same day.]

AFTER RECESS

The committee reconvened at 2:47 p.m. in room SD-342, Dirksen Senate Office Building, Hon. William V. Roth, Jr., chairman of the committee, presiding.

Present: Senator Roth.

Chairman ROTH. The committee will be in order, and we are very pleased to have as our first witness this afternoon the distinguished Senator from New Mexico, the chairman of the Budget Committee, who has done such an effective job in both capacities. We are very pleased to have you here with us.

TESTIMONY OF HON. PETE V. DOMENICI, U.S. SENATOR FROM THE STATE OF NEW MEXICO, ACCOMPANIED BY CAROL HARTWELL, SENIOR ANALYST FOR NATURAL RESOURCES

Senator DOMENICI. Thank you very much, Mr. Chairman.

With your permission, I am going to ask Carol Hartwell from the Budget Committee, who is our staff expert on this, to sit with me. In the event you are overly inquisitive, I will have to ask her for answers.

Chairman ROTH. I know the problem. [Laughter.]

Senator DOMENICI. At least we are willing to admit it.

Mr. Chairman, I have some prepared remarks, and I think they are about as good a statement of this as I can make, so with your permission, I would like to give these remarks to you and clearly, I would be delighted to answer any questions you might have.

First, I think you know that I appreciate the opportunity to testify before you on Senate bill 2142 and the related issues, the sale of existing assets. Obviously, this is a very serious issue, and I commend Senator Trible for his continuing interest in the Federal credit programs.

This is a subject that has been studied a number of times in the past, but obviously, in these particular times, it has assumed a new importance because of the deficit climate that we are in and because of interest rates coming down.

As I understand it, Senator Trible's bill stems from a longstanding concern that the Federal budget, which operates on a cash-flow basis, doesn't do a very good job of measuring the cost of credit assistance. In some cases, the budget seems to penalize loan programs by scoring the full amount of direct loans as budget authority and outlays. On the other hand, the cost of some programs may be understated because repayments of old loans offset new obligations.

What is missing is an accurate picture of what these loan programs actually cost the Federal Treasury. Several years ago, someone came up with the idea of establishing a separate credit budget to deal with the shortcomings of the regular Federal budget. Instead of measuring cash-flow, the credit budget measures the level of new credit authority, that is, direct loans and loan guarantees, obligated in any given year.

The problem with the credit budget is that it still doesn't tell us how much a loan program costs the taxpayers. A dollar's worth of credit assistance in one loan program looks just like another, no matter what the interest subsidy or default rate.

Under current practices, then, neither the regular spending budget nor the credit budget does a very good job of telling us what the loan programs actually cost. This weakness is nothing new, but it is now giving us cause for concern because of a number of credit proposals being developed in the name of deficit reduction.

In the last couple of years, many loan programs have been targeted for large cuts or elimination as a means of reducing Federal spending. In response to these pressures, we are seeing proposals develop that avoid real program cuts through financing changes. These changes would reduce outlays, but in some cases, would actually increase the long-term cost to the taxpayers.

A proposal like Senator Trible's "Market Plan" offers one way to improve the budgetary treatment of loan programs and remove the incentive to adopt financing gimmicks. I am not yet prepared to endorse this particular plan, but I do believe that it is time that we give this issue very serious consideration.

There was a similar concern that caused the senior Senator from Pennsylvania, Senator Heinz, to offer an amendment to the Senate budget resolution calling for comprehensive reform of the Federal credit budget. The acceptance of the Heinz amendment by the managers can be viewed as an indication of the Budget Committee's interest in this issue. And I commend you, Mr. Chairman, for your genuine and abiding interests in this area.

Should this bill, or the one before you, be adopted by your committee, the Budget Committee will give it the fullest possible review. The plan proposed by Senator Trible may well be an improvement over the present system, but it would fundamentally change Federal credit activities and should be carefully examined.

Mr. Chairman, I would like to take this opportunity to discuss a subject closely related to Senate bill 2142, the sale of existing assets, both physical and financial.

I raise this issue because the budget adopted by the Senate on May 2 includes asset sales in a number of areas.

As passed by the Senate, the budget resolution assumes the sale of two major physical assets, Conrail and the naval petroleum reserve, as well as a large part of the administration's pilot program of loan asset sales. Taken together, these proposals are assumed to reduce outlays by $2.6 billion in 1987 and $3.7 billion over the 3 years.

In private meetings on the budget last month, and earlier this month, the administration has indicated to us that it would press for even more financial asset sales. Incidentally, the House budget reported last week assumes $1.5 billion more in fiscal year 1987 outlay savings from asset sales.

As I understand it, those in the private sector who are attempting to work with the Government and arrange such sales, are meeting both confusion and resistance. The official administration line, and I don't doubt its sincerity, is that such sales should be encouraged. But it is obvious from Conrail that many in Congress and the bureaucracy have doubts and are moving quite slowly.

We need only to look at, as I indicated, the recent Conrail experience to understand the problems that confront various proposals for asset sales. I don't know how many private sector companies or consortia will feel comfortable, after the Conrail experience, offering to purchase assets without a conclusive statute that makes their bid final and worthwhile.

Regardless of one's policy views on the Conrail sale itself, the process should give everyone a great deal of pause and certainly, a great deal of concern.

I might also indicate that in the reconciliation bill for 1985, some money is allegedly saved by the sale of some portion of the Farmers Home portfolio. I am informed that, No. 1, the regulations are required to be published within 90 days. I am very skeptical as to whether the regulations would be ready.

Second, the way the statute was drawn, it is very doubtful whether the end product will save money, because as a matter of fact, the Government remains the guarantor. We are going to pay a higher interest rate because we agree to subsidize in a very specific way. This brings us to the general proposition that I raise before you because I believe your committee has some significant jurisdiction in the area.

Congress gave guidance to the Transportation Department on Conrail. The Department, following that guidance to the best of their ability, arranged that sale. The private sector responded, and a buyer was found. Then Congress got a second bite at the apple, so as to speak. The result: Conrail is still not sold. The receipts assumed in the budget that we approved last year have not flowed into the Treasury and our deficit will be higher by that amount and yes, we did it again: It is now assumed that it will take place this year.

The Naval Petroleum Reserve is assumed to be sold the year after next, not in 1987. At least on that one we gave enough lead time with the assumption to make some degree of sense in terms of up-front planning. The budget proposed by the President and the one adopted by the Senate, the one reported by the House committee, all assumed that the deficit in 1987 will be reduced significantly through the sale of existing assets.

Yet I asked the question, will those savings really be realized? Right now, the Congress is proceeding on what I would call an ad hoc basis with a hit or miss quality that I believe begs for some kind of consistency. If we are to be truthful in our budgeting, we need to act quickly to establish an orderly process that will make asset sales a reality, not just some entry in our budget resolution or some wish list or hope.

While the Governmental Affairs Committee will not directly write the legislation providing for these sales, it might be wise to develop legislation that establishes general guidelines working with other authorizing committees.

Mr. Chairman, if the committee decides to undertake such an endeavor, it will be confronted with questions like the following: How should sales be structured to get the best possible return to the

Government? That should be done by a statute which everyone understands up front.

What will it take to devise a marketable commodity, and how would one define that? Should assets be sold with any form of guarantee or recourse? If so, that should be done in advance so that everyone knows the nature of the ball field that they are playing on as they attempt to package these in the private sector.

Third, how ~~can~~ we take advantage of private sector servicing and still be sure that borrowers receive the protection intended by Congress?

All of those, it seems to me, and others by those more expert than we are, are questions that have to be answered in some kind of generic legislation, which I believe ultimately is the only way that we are going to solve to the problem that I have just described and that you, Mr. Chairman, are fully aware of.

Let me conclude by stating my interest, as chairman of the Senate Budget Committee, in the kind of budgetary reform envisioned by S. 2142. I am concerned, and I believe that we must carefully evaluate this and other proposals to ensure the proper treatment of Federal loan programs in the future.

In the meantime, I urge the committee to begin to develop guidelines for the sale of existing assets and to work as quickly as possible. If we are to be truthful in our budgeting, as I said earlier—that is, actually make assumptions which do not thrust upon either the administration or other committees unworkable propositions or have in their way stumbling blocks that we are not aware of, or have in the way market inhibitions that we did not take into consideration—we must move in this area. Or else, we must stop taking advantage of sales of either assets or loan portfolios that are really not going to occur.

We must reduce the chances of these eventualities not reaching fruition. Indeed, it seems to me that this is one of the most significant challenges confronting us at this time. Many are saying we should just put publicly owned assets out there for sale to the private sector. I don't believe we will do it in a very reasonable way. I don't believe we will achieve the kind of return to the Federal Government we have planned for unless and until we take much broader action of some generic type with reference to these propositions.

I thank you very much, and our committee stands ready any time to assist. I stand ready, Mr. Chairman, to be of assistance personally and with any of our staff. I thank you for your interest and for accommodating me this afternoon.

Chairman Roth. I thank you for coming here and for your very interesting suggestions. Let me ask you one question that deals with the problem of trying to develop some generic legislation.

Part of the problem, as you pointed out, in the case of Conrail, was a second bite, so to speak.

Senator Domenici. Yes, sir.

Chairman Roth. Do you think that we could authorize any kind of sales without giving Congress a second chance to review the actual proposal?

Senator Domenici. Mr. Chairman, I have discussed this—I should be fair and say not at length and not even in depth—with my staff and with those that I would consider informed in the marketplace. It does seem to me that while most probably there would have to be congressional involvement, generic legislation would lay out the playing field and cause events to occur where the bureaucracy would get to a point where things are ready.

I think the second review that you are speaking of—the second bite of the apple—would still be there. But there are ways to do that. Don't create the same kind of second bite that is occurring now. I think it can be something considerably different, maybe a disapproval of some type at a very early point in the process. That reaches a point that a bid is going to go out and then you say yes or no to letting it out, and I haven't checked the constitutionality of that yet, but I think we could draw that in a constitutional manner.

Chairman ROTH. Going back to the specific proposal of Paul Trible, I, like you, congratulate him for his strong leadership in this area. I also think the proposal has great merit, but it undoubtedly needs considerable reworking and perhaps some kind of a trial run as a first step.

What I would like to suggest is that our staffs get together and discuss this problem, because we would like to move ahead. It does seem to me that there are some real opportunities in this area to meet the targets laid down for us in Gramm-Rudman, and that until we resolve or establish some procedures, we are overlooking an opportunity to make government more effective and also more efficient.

I think there is a great deal of merit in the selling of unnecessary assets, but it does have to be done in a careful way that will gain the support of the Congress at large. So rather than going through a number of questions right now, I am going to ask my staff to contact whoever is appropriate on yours and then perhaps at a later time, we should discuss it ourselves.

Senator DOMENICI. We would be glad to do that. We will work with you in any way. If and when you complete your work—and I don't know how soon that will be because this is a serious issue and it is difficult to envision this immediately—but we have a very short referral time, as I understand it. We will act . . . , very quickly, we commit that to you. We will them 30 days and may be able to do it quickly.

If we work together this way, it may expedite the whole process.

Chairman ROTH. It seems if we can do anything meaningful in this area, it is going to have to have broad support.

Senator DOMENICI. I think that is correct.

Chairman ROTH. I think if we can agree, that would be a positive step forward. Thank you very much.

Senator DOMENICI. Thank you very much.

Chairman ROTH. We will now have a financial management panel consisting of Ted Sheridan, who is a professor at the Columbia Business School and former chief financial officer at AMF Inc. Mr. Sheridan is representing the Private Sector Council. Mr. Roland Burris is the elected Comptroller of the State of Illinois and the vice chairman of the Democratic National Committee, representing, as its president, the National Association of State Auditors, Comptrollers and Treasurers. Next we call Lester Hammar, the vice president and controller of Abbott Laboratories, representing the Financial Executives Institute and Ed Mazur, Comptroller of Virginia, co-chairman of the State/Federal Cash Management Task Force representing the National Association of State Auditors, Controllers and Treasurers.

TESTIMONY OF J. EDWARD SHERIDAN, PROFESSOR OF FINANCE, COLUMBIA BUSINESS SCHOOL,[1] REPRESENTING THE PRIVATE SECTOR COUNCIL; ROLAND W. BURRIS, COMPTROLLER, STATE OF ILLINOIS,[2] AND PRESIDENT, NATIONAL ASSOCIATION OF STATE AUDITORS, COMPTROLLERS AND TREASURERS; LESTER E. HAMMAR, VICE PRESIDENT AND CONTROLLER, ABBOTT LABORATORIES,[3] REPRESENTING THE FINANCIAL EXECUTIVE INSTITUTE; AND EDWARD J. MAZUR, COMPTROLLER OF VIRGINIA,[4] COCHAIRMAN OF THE STATE/FEDERAL CASH MANAGEMENT TASK FORCE, REPRESENTING THE NATIONAL ASSOCIATION OF STATE AUDITORS, CONTROLLERS, AND TREASURERS

Chairman ROTH. Gentlemen, I am delighted to have each of you here this afternoon. I would ask, because of time constraints, that you summarize your remarks, but your full statements will be included as if read.

Mr. Sheridan, would you please start?

Mr. SHERIDAN. Thank you, Senator Roth.

I am Ted Sheridan, a professor at the Columbia University. My previous experience includes 12 years as a chief financial officer and 10 years in financial positions including work for Peter Grace at W.R. Grace and Co., and at Westinghouse and Lockheed, all corporations with substantial assets, complexity and international operations.

I am here representing the Private Sector Council as a member of its Chief Financial Officers Task Force, and the Chief Financial Officer's role in Government is the particular aspect that I wish to address today.

The Private Sector Council is a nonprofit, nonpartisan organization that is working with Federal agencies assisting them in improving management and reducing the national deficit. Since 1983, it has been working with nine Federal departments and agencies and has completed projects which have been credited for assisting Federal officials on projects that resulted in saving of at least $1 billion in interest and $8 billion in working capital reduction.

This familiarity with the operations of certain Government financial management, coupled with the fact that the operating executives of the task force are chief financial officers in their own rights, some 30 of us, gives us some perspective in developing concepts that might be helpful to this committee.

It is worthwhile that we review briefly, if only to give some perspective on how the chief financial officer's role developed in the private sector.

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[1] Mr. Sheridan's prepared statement may be found on p. 360.
[2] Mr. Burris' prepared statement may be found on p. 372.
[3] Mr. Hammar's prepared statement may be found on p. 380.
[4] Mr. Mazur's prepared statement may be found on p. 387.

This is largely a development since the Second World War as a result of the changing complexity and diverse activities of large corporations. The role that at one time had been really relelated to that of bean counter and keeper of modest financial assets became involved not only in the keeping of the keys, but also in policy and line management functions as well.

As the importance of the role as financial director of the corporation emerged, his role in the hierarchy of the corporation has been increasingly elevated. That is because it was necessary, as this role evolved and expanded, for the chief financial officer to become a focus upward of all financial activities within the corporation. This would include Treasury; budgeting; controllership or comptrollership, taxation, and all aspects of the financial management of the corporation. This individual has become the adviser to the board of directors, to the chief executive officer, and now sits as a member of the highest policy deliberation body within the corporation.

So throughout the corporation, his role as the chief policy definer and the one who promulgated such policy downward became extremely important. Within most organizations, the chief financial officer, through his corporate comptroller, will have a very strong dotted line relationship with the various business unit comptrollers or directors of finance.

I would suggest that this notion is one very closely paralleling the thoughts that are philosophically embodied in S. 2230.

One of the things that we have seen in the private sector that has become so important and one that those of us who sit on the Private Sector Council find ourselves concerned with here in Washington is the subject of fragmentation of central authority for financial management matters.

We are also concerned with the lack of continuity and the inadequate resources committed for the satisfactory completion of financial management improvement efforts.

As to the fragmentation issue, I think it has been addressed by Mr. Connors of Price Waterhouse and also by Chuck Bowsher. But I don't think that the issue can be in any way diminished, just because it has been spoken to before. I think it is one of the key problems that faces us as the Government tries to develop a more significant, a more consistent, and a more useful type of financial management.

The second issue that concerns us is one of continuity. From our experiences as chief financial officers within complex corporations, we can vouch for the fact that it takes a significant period of time to get one's arms around key problems and an even greater period of time to be able to develop programs to address those concerns.

We also worry that the tenure for political appointees, who I am advised in many cases are 18 to 20 months, simply does not provide the continuity that is necessary.

Our great concern is that the "top" financial manager, and I think this is a question of his leadership as much as structure, does, indeed, have the clout that Senator Eagleton thinks is so important—clout because of position, clout because of the ability to corral and bring together the resources, clout because he/she would be a person that would command the respect of career financial managers, and clout because he/she would need to get things accomplished timely, efficiently, and effectively.

Last, I would like to comment on the notion of the resources to be brought together. Although it has been addressed before, I think it is important to say so. One thing that we would like to have considered, and I don't believe is now in this legislation, is that a line-item designation of funds for improvements in the financial area be established and possibly one that would span more than a 1-year budgetary period.

We in the Private Sector Council do not feel that it is appropriate to indicate, at this point in time, the exact structure of the chief financial officer's office and where it would be placed within the Federal Government. However, we would like to suggest that our group, that is one representing 100 of the largest corporations in the United States, could provide a private sector perspective and be a resource for this committee and others as they contemplate this very important piece of legislation.

We would appreciate it if comments in my written testimony relating to the specific items in other financial management areas contained in S. 2230, and others incorporated in a "Strategy for Improving Federal Credit Program Management," a document which was supplied to the Senate Budget Committee staff 2 years ago by the Private Sector Council, be included for the record.[1]

In summation, the Private Sector Council is very much interested in this legislation. We think S. 2230 provides momentum and substance going forward on many of the issues that we think are important to improving Federal financial management and we would like to support deliberation on it in any fashion that we can.

Chairman ROTH. Thank you, Mr. Sheridan.

I am going to interrupt, because Senator Heinz is now here. I know he wanted to be here earlier, but unfortunately could not. So Jack, if you would just come up now?

Senator HEINZ. Mr. Chairman, thank you. I apologize to the witnesses. I thank them and you for your forbearance.

TESTIMONY OF HON. JOHN HEINZ, U.S. SENATOR FROM THE STATE OF PENNSYLVANIA

Senator HEINZ. If it would be appropriate, I do have some testimony I would like to present to you for the record.

First, let me compliment you and your committee for taking a very close look at the careful management of Federal Government resources. As you know, as we applied the brakes to Federal spending, many of us, including myself, have become particularly concerned about the haphazard way in which some credit programs have been cut without reference to true budget savings, while others have, frankly, just been moved off budget, and we have ended up with very uneven budgetary treatment.

To remedy that, I amended the Senate budget resolution with a sense of the Senate budget amendment, and I introduced legislation last week, the purpose of which is to assure that credit is effectively controlled, appropriately allocated and efficiently marketed through what I would call a subsidy-based mechanism. I know that is a goal common to your bill, S. 2230, Senator Trible's credit reform bill, S. 2142, and others. So I do applaud the good work you are doing in these areas.

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[1] See p. 360.

My bill is S. 2428, and it is entitled the Federal Credit Program Revolving Fund Act. It is intended to correct deficiencies in credit management that I believe, in part, originate in the budget accounting for credit programs. As we all know, the present system requires full appropriation for some programs; occasional infusion of funds for revolving funds, and Government capitalized public enterprises and no effective control for other programs. Guarantee programs tend to have their costs understated, while direct loan programs are often scored the same as spending programs—the Ex-Im Bank comes to mind—that yield no fees or reflows.

S. 2428, my bill, addresses these problems by proposing a true cost accounting methodology for all credit programs based on their subsidy cost and, in addition, a uniform rule based on a single standard of measurement, in this case, the subsidy cost to ensure accurate comparisons among credit programs and between credit and spending programs.

It is my expectation that this change will enable the Congress to better balance program costs against the benefits that derive from meeting the various social and economic objectives of Federal programs.

As a measure of the total cost of credit to the budget, I submit this approach represents a clear improvement over the outlays-only focus in the unified budget. My proposal would record budget costs when any Government credit commitment was made regardless of the funding source, not when a guarantee claimed is paid, the disbursement on a slow-spending loan is made, or new capital is needed by a revolving fund.

Incentives for budget gains like the administration's proposed off-budget interest-matching scheme for the Eximbank—they refer to it as the IMATCH program, with which I am quite familiar as chairman of the subcommittee which authorizes such programs—would be eliminated, and it would no longer be possible to increase program costs, put the full faith and credit of the United States on the line, and make direct subsidy payments to commercial banks while eliminating all trace of the program in the unified budget totals. That is what I call real voodoo budgeteering.

To achieve these goals, our bill, S. 2428, amends the Federal Financing Bank Act to establish a central loan fund within the Treasury Department to serve as a central financial manager for all Federal credit programs.

This fund will accept subsidy payments and fees from agencies; raise funds for loan disbursements and claimed payments under their programs, and sell or reinsure loans and guarantees in the credit market where this is deemed appropriate.

As an arm of the Treasury, this fund will be able to rely on efficient Treasury borrowing for necessary funds and will have access to and can further develop agency expertise on credit markets necessary to assess agency subsidy costs and to handle marketing and reinsurance of credits.

The fund would permit comprehensive credit reform within the context of current credit programs or serve as a transition mechanism for extensive marketing of Federal credit.

Since it would be on budget, the fund would not alter the calculation of the budget deficit. Each credit program would continue to manage its loans and guarantees according to its own policies and eligibility guidelines. We don't interfere with that kind of special tailoring.

The level of new credit activity for each program would be controlled through annual appropriation of subsidy costs as well as credit limitations on total credit activity. If the Appropriations Committee wanted to limit budget authority appropriated for new loans, such as credit activities of the Export-Import Bank, that would be unchanged.

However, what would be different, what would be changed is that the incentives in a subsidy-based budgeting system would promote more effective debt collection efforts and overall improvement of Federal credit management practices by altering the pricing of future programming based on the record of past performance. That is really what it is all about.

The fund would also be expected to make available better and more comprehensive data on Federal credit activities than is now available, and finally, up-front subsidy payments, as is proposed in this bill, would ensure full advance funding of credit programs, including adequate reserves for loan losses and guarantee defaults. This is a pay-as-you-go approach, and it would avoid the hidden costs that many programs have. Since all programs would pay and subsidy payments assessed would be assessed regularly; they would be regularly updated and based, to the extent possible, on market sale or reinsurance.

Let me just close, Mr. Chairman, by noting that the language of the Senate budget resolution states, and I believe we all recognize, that credit reform is long overdue. S. 2428 is, I submit, a workable mechanism for such reform.

We will be taking up the bill in the Senate Banking Committee, on which I serve, and I urge you to give it your full consideration, as well.

I do thank you, Mr. Chairman, for giving me this opportunity to join you here today in your committee and to urge early reform of the Federal presence in the credit markets. I again commend you and your committee for taking this very necessary and important step.

Chairman **Roth**. Thank you for coming forward this afternoon to present your bill. I agree with you: This is an area in great need of reform, and I applaud your leadership. Because we have a panel, I won't detain you longer, but we will be in contact, undoubtedly.

Senator **Heinz**. Mr. Chairman, thank you, and let me express appreciation to the four members of your panel. They have been most kind and generous to let me interrupt them in their testimony, which I am certain is equally if not more important.

So thank you, Mr. Chairman.

Chairman **Roth**. Thank you, Senator Heinz.

Mr. Burris, I think you are next on the list.

Mr. **Burris**. Thank you very much, Mr. Chairman.

I am Roland Burris, the comptroller, State of Illinois and representing the National Association of State Auditors, Comptrollers, and Treasurers, of which I am president.

We are very pleased to have the opportunity, Mr. Chairman, to express our position on S. 2230.

I think the chief financial officer is an idea whose time has come. My position on this is covered in more detail in my written presentation. I will just touch on the highlights here in the interests of your time schedule.

The biggest entity in the world needs a chief financial officer. The U.S. Federal Government should have financial accountability, accounting and other financial management practices in place. It is required for our local governments, for State governments, and, as you just heard, major corporations have a chief financial officer.

So in stating that this is an idea whose time has come for the Federal Government, it is important to note the following reasons: To ensure uniformity in the accounting practices throughout the Federal Government; to help eliminate fiscal mismanagement of the largest operation in the world; to provide consistent and useful financial information to the Federal Government and to the American taxpaying public; and ultimately to help make the best use of increasingly scarce resources called tax dollars.

We request, Mr. Chairman, that this position be given adequate clout within Federal operations to assure that the individual who carries this title will be able to get his or her arms around the operations and move the bureaucracy into a consistent Federal reporting system.

The individual must be an independent person in the executive branch of government with a rank comparable to that of the U. S. Comptroller General of the United States. At a minimun, the position should be comparable to the Director of OMB.

We are saying that the term of office should be 15 years, like the U.S. Comptroller General. However, this is an area where we can certainly consider an adjustment, provided that the term is not contiguous with the Office of the President because of political considerations. The term of office should exceed 4 years. Some suggest a 10-year term, which would not be objectionable to NASACT.

The chief financial officer must have specific authority to keep funds and receipts, and appropriation account balances for the Federal Government. He or she would also be the primary disbursing officer to assure that records are available for the control of disbursements. The officer would also be vested with what we in State government call preaudit authority, where, if vouchers are not properly documented, and therefore, not properly authorized by law, they are rejected.

In analyzing the Federal Government's current system, where agencies authorize payment, certify vouchers and notify Treasury and Treasury writes a check, I am amazed that the system has not been questioned before. I think your bill addresses some problems that State governments are moving to resolve, and we are becoming a little more sophisticated in assuring financial accountability.

I submit that the office of the chief financial officer should be structured to assure adequate backup and support staff that would provide for the operational authority to be able to carry out his or her functions.

In addition to the preaudit authority and in terms of being accountable for taxpayers dollars, there should be created, within this operation, a Federal Finance Counsel, Mr. Chaiman, so that financial management policy can be set in a manner that would cut down on turf problems. The Council would consist of the chief financial officer of the Federal Government, the U.S. Comptroller General, the Director of the Office of Management and Budget, the Secretary of the Treasury, and the Director of the Congressional Budget Office.

So, on behalf of the National Association of State Auditors, Comptrollers, and Treasurers, we heartily commend you for introducing S. 2230; however, we want to emphasize that if is important for the Chief financial officer to have real clout, in order to bring financial accountability to our Federal Government.

Thank you very much for the opportunity to appear before this committee.

Chairman ROTH. Thank you very much, Mr. Burris. Mr. Hammar.

Mr. HAMMAR. Good afternoon, Mr. Chairman and members of the committee.

My name is Lester Hammar. I am vice president and controller of Abbott Laboratories, located in North Chicago, IL. I appear before you today as a member of the Committee on Government Liaison of the Financial Executives Institute. The FEI is a professional business organization of individual members who are senior financial and administrative officers in business organizations throughout the United States.

We have over 13,000 members who are affiliated with some 6,000 companies in virtually every segment of the economy, and we therefore represent a broad cross-section of American business.

Mr. Chairman, we appreciate this opportunity to appear before the committee today. We do so, however, with some qualifications.

Our association is made up of men and women professionals who have made careers as financial executives. We offer to you the combined expertise of our membership.

As financial officers in the private sector, we have far less exposure and experience with respect to the public side of financial management. That does not mean that we are not aware of many of the differences that characterize our financial systems.

However, there are some fundamental principles of financial management that apply to both sections. In the interest of time, my statement will be limited to subchapters 2 and 3 of title I of the bill, and I would just highlight the items that are in our prepared statement.

First, the related position, something equivalent to the Chief Financial Officer or Administrator as defined in your bill for the Federal Government, is sorely needed.

Most business failures and frauds are caused by a lack of effective financial management. I believe the same thing is true in the Federal Government. The enforcement of financial controls is only effective if they start with and are strongly supported by the chief executive of any organization and his governing board of directors.

Although we understand there are major differences between managements within the private sector and the public sector, we strongly believe that some of the same principles apply to the Federal Government.

More specifically, Government needs to have and to enforce a consistent set of financial reporting standards so that the executive branch and the Congress have reliable and easily understood financial information on which to base their decision applicable to the operation of the Government.

Second, Federal executives need to have financial systems that provide budgets by line item for each area of operation within each agency and accounting systems that will report these amounts expended against these budgets on a consistent basis. The Grace Commission and the GAO and others have reported over and over again about inconsistencies and the failures of the current system.

As in the private sector, these systems should be used to hold managers responsible for their results and to measure the value of goods and services received against the cost. The President and the Congress could then use the reports to judge the effectiveness of these agencies. I think that is one place where we are sadly lacking.

In order to achieve this goal, the Chief Financial Officer or Administrator should have the authority and the clout to ensure that all agencies follow consistent accounting rules and regulations, many of which are already in place but are not fully enforced.

Our chief concern with your bill is the reporting relationship of the administrator, who we would call a chief financial officer. In almost all industrial companies, the chief financial officer reports directly to the chief executive officer. He or she cannot be effective without this high level support, and we strongly believe that the same thing is true in Washington. Therefore, we believe that the position should report directly to the President instead of through the Director of the Office of Federal Management, as in your bill.

We suggest a broad interpretation of the role rather than a more narrow definition. We also feel that the administrator of the chief financial office should have a very strong role in selection and in performance ratings of the agency controllers, as well as the right and the obligation to ask for their removal if they are not performing their duties effectively or within the established guidelines.

Without this relationship, I don't believe that effective reporting or controls can be enforced. I also believe that this relationship would help to solve some of the questions of enforcement that you and Senator Eagleton addressed this morning in your questions to Mr. Bowsher. However, I don't believe that anything would work, despite what the legislation says, if the President does not support this position. The support would include replacing a Cabinet Secretary if he doesn't live up to the rules.

We thank you for this opportunity to testify before your committee. Our organization would be willing to assist you or your staff in any way possible. I would be happy to answer any questions that you have. Finally, we have a full group meeting of our group in Washington next June. We would love to have you or one of the members of your committee join us for lunch if that is possible.

Chairman ROTH. Thank you, Mr. Hammar. Mr. Mazur.

Mr. **Mazur**. Chairman Roth, it good to be with you this afternoon.

I am comptroller, Commonwealth of Virginia, a post that I have held for 6 years, and I am now serving under my third Governor.

I am also cochairman of the State/Federal Cash Management Task Force which includes 12 senior State and Federal officials including two elected State treasurers. I am here today on behalf of NASACT, the National Association of State Auditors, Comptrollers and Treasurers, to express our support for the intergovernmental financing provisions of S. 2230 as found in title IV.

In addition, to my appearing here today, I have submitted written testimony that explains more fully the role of the State/Federal Cash Management Reform Task Force in contributing to the intergovernmental financing provisions of S. 2230 and the basis of NASACT support for this proposed legislation.

Given the limited time we have today, I thought it would be most useful to you and to your associates for me to review what I believe to be the four most important benefits that will be derived from what we hope will be the prompt enactment and implementation of the intergovernmental financing positions.

These four benefits, which we believe are shared equally by the States and the Federal Government, are as follows:

One, premature drawdowns of Federal funds by States, a problem noted by the Grace Commission, will cease. This means that the Federal Government will have its funds available to it, for longer periods, before they are committed to the States.

Two, States will no longer be required to utilize their own tax revenues to support federally assisted programs because they are awaiting the receipt of Federal funds. This is the other side of the coin, and it was a problem noted by the JFMIP studies that occurred in 1982.

Three, literally hundreds, of State and Federal financial officials who work to help manage federally assisted programs will, from this legislation, readily understand that they have personal and defined responsibilities for effective cash management practices. I believe they lack that guidance in current legislation. That would be overcome, I believe, by the wording in your legislation.

Four, this legislation will create an overall environment that will help senior State and Federal fiscal administrators to move more quickly to employ newer technologies, such as EFTS that you bill mentions, that are available for controlling and carrying out the transfer of funds. Again, that kind of enhanced control, I believe, will help keep Federal money in your hands, available for other purposes until that last moment when it has to be committed to the States.

Mr. Chairman, I want to provide assurances to you that the interest exchange provisions of your bill are, we believe, very necessary, so that Federal and State officials, such as myself, can know whether or not we are all doing what we should do under the terms of the legislation. This is the way we monitor our respective performances.

What will the impact of the interest exchange provisions be on states? I can give you a very simple example. If States pay the Federal Government interest, we believe that they will simply be re-turning to the Federal Government earnings on Federal moneys held between the time they are drawn down by the States and the time they are used to pay checks or cover electronic transfers. Accordingly, utilization of other state revenues to make such interest payments should not be involved.

In closing, Mr. Chairman, I am pleased to inform you that the intergovernmental financing provisions in title IV are a direct result of the Senate colloquy held by nine Senators in 1983. These Senators then went on to express their desire to OMB that OMB join with other federal agencies and States to develop a more equitable means of transferring these funds.

For 3 years the State/Federal Cash Management Reform Task Force and other people have worked very hard to respond to the instructions of the Senate, and we hope that this legislation will not only pass through your committee quickly, but through the entire Senate and the Congress so that the benefits that are available from this legislation will be quickly realized.

I appreciate the opportunity to be with you today.

Chairman ROTH. We appreciate your being here today, and I also want to express my appreciation for the assistance that you have given many of the matters incorporated in this legislation.

Mr. MAZUR. Very well.

Chairman ROTH. I see we have a vote. I want to try to ask a few questions before I have to leave.

Mr. Sheridan, I think in your testimony you said you supported providing a line item budget for new system development. The purpose of the chief financial officer would be distribution of these funds to the agencies, consistent with overall long-range planning and objectives.

I gather that this is sort of an idea that would help implement these proposals?

Mr. SHERIDAN. Yes, sir. It is necessary for an individual who is going to embark on a program of financial management improvement which would include not only just systems, but hardware, to be able to demonstrate that he has the resources to be able to move forward with this, both in the sense of being able to impress, if that be the term, his own colleagues, but also those in subordinate roles of financial management within the agencies.

He or she should have the confidence that the resources will be there over a multiyear period to fund these activities and that they will not become part of a budgeteering process that will strip him of his ability to accomplish the task in a timely fashion.

Chairman ROTH. Yet, I gather that from the testimony of all of you that there is general agreement in the way OMB is functioning, at least with respect to management: It is not adequate.

Mr. SHERIDAN. Right.

Mr. BURRIS. That is correct.

Mr. HAMMAR. Yes, sir.

Chairman ROTH. Would each and every one of you answer that?

Mr. SHERIDAN. Yes, sir.

Chairman ROTH. Answer orally.

Mr. SHERIDAN. Yes, sir.

Mr. BURRIS. We agree with that, Mr. Chairman.

Chairman ROTH. Mr. Mazur?

Mr. **Mazur**. I agree that you do not have adequate coverage for true financial management concerns, whether it be OMB or otherwise, and you need to address that in your legislation, move in that direction, and I applaud that.

Chairman **Roth**. The second question I have is, do you believe that financial management is different from other important management functions such as procurement, information resources, which are also impacted by periodic turnover of political appointees?

Mr. **Sheridan**. Yes, sir, I would say that there is a distinction which should be made, because good management techniques are available through all of the various functions that might be served. There is perhaps a greater uniformity and understanding of what good financial management practices are, as what would be understood in the State governments, in the private sector, and could be applied directly to those functions within the U.S. Government.

It is to that end that we, in the private sector and also those that have had similar movements forward in this regard, feel that zeroing in on the financial management because of the uniformity of understanding of what good management practices in this area is an important one that we think that we can support. We would say that, within the entire subject of improvements of total management, addressing the section regarding financial management is probably the one that can be done with the greatest effectiveness at an early time.

Mr. **Mazur**. Senator, I would like to answer that question. I believe that financial management is different from management that exists in other activities of Government for this reason: It is the one function of Government that is charged to represent to you and to the people and to the President and to others whether or not the Federal Government, in this case, is fiscally accountable or not.

There are standards that can be developed and have been developed that will help express that accountability, and there is no other organization or element of Government enterprise that is so charged with that need to come forward with a statement as to that accountability in quite the same way.

Chairman **Roth**. Yes?

Mr. **Hammar**. I would add one more thing to this. The financial manager has to walk a very narrow wire. If he is going to be of good service to his agency or to the President, he has got to be sure that the President uses him for advice and counsel. At the same time, he has to report the facts as they happen. So he has to walk this narrow tightrope between serving his agency director as a financial adviser and being sure that financial information is reported on a correct and true basis.

So he really has two bosses, and he has to be very skilled, if you will, to make sure he works effectively for both of those bosses. That is why, again, I would say that I think the chief financial officer of the Government has got to have some kind of a dotted line relationship or reporting relationship and control over the agency controllers to assure that the system works both ways.

Mr. **Burris**. Mr. Chairman, just one comment.

Chairman **Roth**. Yes, Mr. Burris.

Mr. BURRIS. In relation to that, I think there is a distinct difference between the financial manager and other management functions. Putting a financial manager in place could spin-off to solving a lot of other problems.

If you have good financial management and reporting in place, you begin to identify all types of possibilities in terms of personnel, in terms of costs, and in terms of debt service, that would produce solutions to problems in these areas. It should be singled out, it should be highlighted, and it should be the first aspect that you zero in on, because that would lead to solutions in many other areas.

Chairman ROTH. I have time for just one more question and comment. I am somewhat concerned by the idea that the financial manager should report directly to the President. In seeking to draw an analogy between the Federal Government and business at large, I point out that in a business, your financial chief executive or chief manager, whatever you want to call him, normally has all aspects of financial management. He has the budget, he has the treasury, and he makes the payments. That it is a much broader job than we are anticipating here, whatever direction we take.

I think there is a limit as to how many people should report to the President. There is a tendency currently for every agency and every special interest group to want their piece of the executive branch to report directly to the President. I fear that it ends up being more form than substance and not practical, so that I do have a question as to how we approach it.

I might say also, that I think in a corporation, generally the production and marketing of the product drives the company. The financial management serves that need, whereas I am a little concerned that here in OMB, the budget is driving management.

Yes, then I have to vote.

Mr. BURRIS. Mr. Chairman, that is what happens. If you look at State governments, you find your best comparison. Your larger States, California, New York, either have independent reporting or an elected officer to handle the finances. Yet there are still times when the budget office drives the chief executive. Therefore, you need independent financial information so that reliable, correct data is available. This is important.

Chairman ROTH. Gentlemen, I want to express my appreciation to each of you for being here today.

The committee will be in recess until I am able to vote and return.

[Short recess.]

Chairman ROTH. The committee will please be in order.

At this time, we will hear from two experts who have come today with very distinguished backgrounds in government management and organization. Murray Comarow is a distinguished adjunct professor at American University and served as the Executive Director of the President's Advisory Council of Executive Organization in 1969 and 1970.

As executive director, he recommended reorganization of the OMB and played a major role in the transformation of the Budget Bureau to OMB.

Charles Bingman served as Deputy Associate Director for Organization and Special Studies in OMB from 1971 to 1976 and spent 26 years in other Federal management positions. He is presently a distinguished visiting professor at the George Washington University and is an elected member of the National Academy of Public Administration. We will hear, if we may, first, from Mr. Comarow.

TESTIMONY OF MURRAY COMAROW, ADJUNCT PROFESSOR AT AMERICAN UNIVERSITY,[1] FORMER MEMBER OF THE PRESIDENT'S ADVISORY COUNCIL OF EXECUTIVE ORGANIZATION; AND CHARLES F. BINGMAN, PROFESSOR, SCHOOL OF GOVERNMENT AND BUSINESS ADMINISTRATION,[2] GEORGE WASHINGTON UNIVERSITY

Mr. COMAROW. Thank you, Mr. Chairman for the privilege of submitting my views on this vital bill. My remarks today are confined to title I with one exception: I strongly endorse title I in general and the functions set forth in section 903, in particular. The exception is that part of section 903(a)9B, which would have the director of the Office of Federal Management advise the President "on the qualifications of candidates" for presidential appointments.

As the executive director of the Ash council in 1969 and 1970, I played a part, which you have kindly commented on, Mr. Chairman, in the transformation of BOB into OMB.

The driving principle behind this effort may be derived from four sentences in the Council's first recommendation to the President in a memorandum of August 20, 1969. The Council said, "Abstract organizational principles, per se, have little value. The challenge is one of reducing to human scale the task of coping with the nation's most pressing and changing needs. The only way to meet this challenge is through greater reliance," greater reliance, Mr. Chairman, "upon the agencies. The prerequisite is dramatic improvement of the management processes of the executive branch, with leadership from the President's office."

In my opinion, Mr. Chairman, this particular effort of the Ash council has failed, as have the efforts of many previous distinguished groups as, indeed, has the Budget and Accounting Act of 1921, which never achieved its purpose in getting the Bureau of the Budget to perform its management functions.

So I am delighted that 65 years later, the Senate of the United States is rushing into the breach and is taking steps to see that the 1921 Act is at last given significance. If I had had the gift of foresight when I served the Ash council, I would have recommended and the council might well have agreed that a separate Office of Federal Management, similar to that contemplated in Title I of this extremely professional and thoughtful bill, was indicated.

It might be amusing to the Chairman to note that the Ash council's original name for the new BOB was the Office of Executive Management. Yet, I do not believe for a minute, Mr. Chairman, that passage of S. 2230 will necessarily accomplish its goals.

Presidential indifference, much less hostility, would reduce the impact of the new office to a minimum. And while all Presidents, without exception, claim to have profound interests in the management of the executive branch—and I am sure that they make those claims sincerely—when push comes to shove, most of the tough decisions are politically driven and not management-driven.

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[1] Mr. Comarow's prepared statement may be found on p. 396.
[2] Mr. Bingman's prepared statement may be found on p. 399.

Yet, I believe that this bill represents an extremely worthwhile effort. It could, and I would underline "could," Mr. Chairman, create a new dynamic.

Given proper leadership, given the resources that such an effort would require, it can become, in time, a constant force for management improvement, mostly by the agencies themselves.

At the request of Mr. Gilmour, Mr. Chairman, I have submitted a list of possible areas that you may wish to explore. With your permission, I will not read them and will rest at this point, ready for your questions.

Chairman ROTH. Thank you. We will get to some questions in just a few minutes. But we appreciate your very excellent testimony.

Mr. Bingman, would you please proceed?

Mr. BINGMAN. Thank you, sir. It is an honor and a privilege to appear before the committee to give you my views on S. 2230, and like Dr. Comarow, I will talk primarily about Title I and the Office of Federal Management. Under extreme pressure from Dr. Gilmour, I have a statement which I hope will be under 4 minutes.

Chairman ROTH. So do I. [Laughter.]

Mr. BINGMAN. During my service in OMB, I gained a great respect for that institution and for the values that it served to the presidency. But I felt then, as I feel now, that the management role in OMB had not reached its full potential, and having also spent 26 other years in Federal Government, I was aware of how many tough and important management problems were being faced in the agencies with which OMB provided little help and often a hinderance.

Let me say at the start that I fully agree with the creation of the independent Office of Federal Management. I am one of those who supported the creation of OMB, but after 16 years of hoping and expecting, have come to recognize that the combination of budget and management is a weakness rather than a strength, and the recreation of separate management organization has moved from a possibility to an urgent necessity.

I have prepared a brief report, Mr. Chairman, which, with your permission, I would like to submit for the committee's information.[1] That will contain in more detail what I believe that the OFM should be, why it is needed and what roles and objectives it might play.

I would just to just pick out three major ways in which I think a new OFM would be better than an OMB. First, I think it will serve the President better. The creation of the Office of Federal Management will give the President two strong elements in the executive office. I think that is a big plus.

I don't subscribe to the argument that OFM will be just another piece of bureaucracy. I think that when it comes to the management of the Federal establishment and the role of the President as manager of the government, he needs all the help that he can get.

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[1] See p. 408.

An Office of Federal Management, properly designed and properly led, can make an enormous difference to the President and to the government in attacking the serious management problems which are every day more apparent. In addition, I think OFM will serve the Presidency. I am fully aware of the need for an incumbent President to have staffs for people to serve him, but there is the added necessity for a more permanent, stable organization which will preserve the longer term management improvement and management reform efforts of the Government, and also, Mr. Chairman, to assist each new President as he comes in to office to understand what that agenda is and give him support.

Second, OFM can provide greater leadership and leverage for improving Federal management. Quickly, the Director of OFM will almost certainly be able to give more direct Presidential attention on management problems in a more disciplined and effective way. That, in the executive branch, is clout, not the budget, but access to the President.

Third, free from the tyranny of the budget, the OFM will become more assertive and more independent in shaping the agenda for management reform and pressing it home.

Also, because of its release from the budget, OFM can establish a new and more wholesome relationship with departments and agencies and provide more positive, constructive assistance to agency base efforts to improve management, what I call turning on the talent base.

I want to applaud the way in which S. 2230 lays out, in detail, specific management roles which the Congress expects the OFM to fulfill. I believe this is important, because one of the failures of OMB is at any given time, it has ignored many important management responsibilities, including financial management, about which we have heard so much today.

I think with a comprehensive statutory charter behind it, it will not be able to ignore these missions.

Finally, I think OFM will be more accountable inside the executive branch. I also want to say that an OFM can be more responsive to the Congress and provide more technical assistance and more competent, more innovative management improvement ideas coming to the Congress.

Quickly, I want to wind up my testimony, sir, by making four specific recommendations that might improve S. 2230. One, I believe that, as Mr. Kline said, there is a serious mistake involved in mandating structure in the organization. Second, I know that S. 2230 calls for a management report.

I would strongly urge the committee to upgrade that to a management plan, and I have some more specifics about the values of a management plan for Government in my system.

Third, I think the bill ought to make clear that the role of the Office of Federal Management should include research, development, testing, the stimulation of innovative management improvements and ideas, and I would urge the committee to make sure that there is authorization for appropriation funds for that purpose in OFM.

Finally, there is a provision which OMB has started, which is a management review each year, in which the management issues and management concerns are presented to the Director of the Budget. I think that kind of review can be continued. It ought to be presented by the Director of the Office of Federal Management, and that would be a very important way in which to link those two institutions together.

That concludes my remarks, Mr. Chairman, and I would be glad to answer any questions.

Chairman ROTH. This is just an observation: One of the problems we have here on the Hill is that there are those who don't think that organization is very important. For example, when I was pushing the creation of a Trade Department, there are many reasons to be for or against it. One of the main thrusts against the proposal was, "Well, organization really doesn't make any difference. It is a question of personnel."

Would either one of you gentlemen agree with that?

Mr. COMAROW. Organization can make a difference. It does not necessarily make a difference. I remember when I looked at the old Atomic Energy Commission, which was organized in the form of one horse and one dog, the horse being that part of the Commission which had as its mission the promotion of nuclear energy, and the small dog, about the size of a miniature poodle, that part of the Commission which was supposed to be concerned with nuclear safety.

The safety mission was completely submerged and crushed by the dominant culture of the agency, to promote the use of atomic energy. So we recommended the establishment of the Nuclear Regulatory Commission, a separate agency. All that did was give the function a chance to thrive. It will not survive poor leadership. It will not survive insufficient funding. It will not survive bad management, in general.

But it gave it a fighting chance, and the same is true of many other examples, such as environmental protection, which was being submerged and largely ignored in Interior and in what was then called HEW. Putting it in EPA gave it a fighting chance, not a guarantee of success. A fighting chance, it seems to me, is better than no chance.

And that is the importance of organization. Good organization can make it easier for good men and women to do a good job. It will not guarantee that good job will be done.

Chairman ROTH. Thank you. As you probably heard today, a number of people have made a recommendation that we make a specific management function out of financial management. Do you agree with that, Mr. Bingman?

Mr. BINGMAN. Yes, I do. I would certainly agree. From my experience in Federal Government, I thought financial management is and was a bankrupt experience.

Chairman ROTH. Bankrupt, yes.

Mr. BINGMAN. Second- and third-rate financial management systems; in fact, second-rate professional staffers working on them. The failure of financial analysis to come to the leadership of an organization, whether they want it or not, all of the sins of omission and commission that I heard during the day are, unfortunately, much closer to true than they ought to be.

I think that does require a more powerful institutional base. You asked earlier, sir, whether organization does make a difference. Here I think is a case where it will. I think there has to be some leadership in the Federal Government centering around financial management, even though I don't like some of the ideas that I have heard about locking organizations in.

I have heard a lot of stuff about process and structure and system. I don't think financial management leadership can be of a kind that ignores the authoritative role of agency heads and Cabinet secretaries. I don't think you can create a leadership for financial management to usurp the authority of line managers, but I think you can create the kind of assertive, innovative, aggressive thinking about how to upgrade financial management that I heard during the course of the morning.

Chairman ROTH. Let me go one step further. Does that mean that we should have a separate chief financial officer apart from other management functions?

Mr. BINGMAN. No, I don't think that. I think the idea of making that a part of an Office of Federal Management is just exactly right. I must confess that I heard so much about financial management this morning that one almost got the feeling that if, somehow, we could have the right accounting systems and have them in place in agencies, all would be well.

I think that is not the case. I think there is a major management problem in Government which are articulated in your bill, and I think there is a high congruence of interest and concern between financial management and other aspects of management in Government.

I think it would be a much more powerful organization to have financial management integrated into other activities of Government, many of which are now being ignored by OMB.

Chairman ROTH. Mr. Comarow, would you care to comment?

Mr. COMAROW. I would agree with about 90 percent of what my friend has said. I have a feeling, however, that if you had sitting before you panels of people who were expert in, say, evaluation of programs, you would hear as strong and compelling an argument for escalating that function to the top level as you have heard about financial management.

I know that every member of the Ash Council believed strongly that OMB's executive development responsibility—staying away carefully from advice on specific individuals—was an absolute prerequisite to a good management program.

So I sense, Mr. Chairman, without for a moment derogating the importance of financial management, because it should not be derogated, that there may be a little bit too much emphasis in the bill on financial management to the disadvantage of other extremely essential management functions. The coordination function, it seems to me, should receive a lot more emphasis.

Anyone who believes that the Federal Government can be managed by OMB or by the new Office of Federal Management or by the new Office of Federal Management in combination with the residual Office of the Budget is just kidding himself.

The Federal Government will continue to be managed by the agencies, and the degree to which you can create structure which can reach out to the agencies and encourage and motivate and persuade the agencies to do a better job, to that degree, this bill will have value.

To the degree that it centralizes authority and tries to impose its will upon the agencies, I confidently predict it will fail.

Chairman ROTH. I see we have another vote, but I would like, before I depart, to ask one more question, and that goes back to the so-called question of clout.

What steps should we take to try to ensure that the new organization has some real influence? Should we rely upon leadership? Should we try to give it some kind of financial carrot and stick, or should we give it some authority to move in if the agencies fail to follow through on recommendations?

Mr. BINGMAN. Let me try that. I was listening to that discussion of clout with sort of two attitudes. One, I thought that S. 2230 had made what I thought was the essential provisions for the authority of a Director of the Office of Federal Management as a Cabinet officer; he will sit in the Cabinet. He will deal with the President, and, I emphasize, my experience in OMB tells me that it was not the budget per se that represented clout, but it was the capacity of the Director of OMB to deal with the President as the Chief Executive Officer of Government.

If you arrange it so that the Director of the Office of Federal Management also has that relationship with the President, that is serious clout in my book. You are also talking about a much more competent professional staff. You are talking about a range of responsibilities defined in statute which mandate the role and the objectives of that Office of Federal Management; something that the management activities of OMB have never had. And I think there are other congressional laws and statutes that would be administered by the Director of the Office of Federal Management so that he is not without authority in his role inside the executive branch.

I think beyond that, obviously, there has to be a willingness on the part of the President to appoint people that are managerial and competent.

If I may, just on the sort of the dark side of that clout issue, clout is viewed as sort of a simple-minded attitude that you only deal with those issues that have greatest political leverage. That kind of view of clout gets you into a place where we have got subsidy programs in the Federal budget to begin with; that concept of clout gets you an OMB that feels free to ignore the management side of its own responsibilities; that clout gives you the kind of clientele who think somehow that they don't have to repay money that they owe to the Federal Government; that kind of clout gets you bureaucrats that get scared about trying to collect debts because they are not sure whether that is going to create political trouble or not.

I think there are good kinds of clout, and I think you have got most of the right apparatus for good clout in your bill.

Chairman ROTH. Thank you.

Mr. Comarow?

Mr. COMAROW. Mr. Chairman, I think that what you can do to give to OFM Director clout is limited. You cannot force the President to see this individual. President Kennedy decided that he was not going to use the machinery of the National Security Council, and he didn't, and he regretted it on one or two occasions. But that was his decision alone. If you created this office, and if it were fully functioning tomorrow, and if you were a fly on the wall keeping track of how many times President Reagan or the next President would see the Director of the Budget as against the Director of the Office of Federal Management, I dare say that he would see the Director of Budget about 5 times or 10 times as often as he would see the Director of Management, regardless of what you put into the bill.

And if he decided that he wasn't going to see the Director of Management at all, then he wouldn't, just as Presidents sometimes don't see Cabinet members except pro forma.

What you can do, as a Senate committee, and the House can do the same, is one, require management plans; two, see to it that those plans are carefully reviewed; and three, bring the attention of the public to bear upon any slipshod or casual treatment of OFM's responsibilities under the bill.

That is very powerful stuff. I believe that the bill is worthwhile in a sense of expecting reasonable incremental improvements in the management of our total system. One is doomed to grave disappointment if one expects monumental changes as a result of this legislation.

That is not a pessimistic point of view, Mr. Chairman. I believe that incremental improvements in this massive structure of ours are very much worthwhile, worth working for and worth fighting for.

Chairman ROTH. I suspect if we were going to see monumental changes, we would have a lot broader participation on the part of the committee in this kind of a matter.

Mr. COMAROW. Yes, sir.

Chairman ROTH. Gentlemen, I want to thank you both for your very helpful and illuminating testimony. I would just like to publicly thank you for the help you have been giving and for the splendid service you have given our Government. Thank you very much.

Mr. COMAROW. Thank you for the privilege, Mr. Chairman.

Chairman ROTH. The committee is in recess for 10 minutes.

[Short recess.]

Chairman ROTH. The committee will please be in order.

At this time, we call forward Miner Warner, who is vice president and manager of Government Finance Group of Salomon Bros. and Dr. Christopher Snyder, president of the Loan Pricing Corp. in New York. Gentlemen, please have a seat.

Mr. Warner, would you please proceed?

TESTIMONY OF MINER H. WARNER, VICE PRESIDENT AND MANAGER,[1] SALOMON BROTHERS, AND CHRISTOPHER L. SNYDER, JR., PRESIDENT,[2] LOAN PRICING CORP.

Mr. **Warner**. Thank you. I am delighted to be here this afternoon and to be sharing views with respect to Senator Trible's bill. I would like to submit my written testimony for the record and then summarize a few key points.

One point we would like to summarize is that in order to maximize value on the sale of nonrecourse assets, it will be necessary to arrange bulk sales and not pilot programs. In addition, loans originated under different programs cannot be mixed. We are looking at a programmatic sale here. The agencies which administer those programs which generate loan sales should have the primary responsibility for the arranging of those sales. Loans cannot be sold individually at maximized value.

A negotiated sale method, rather than the auction method, will maximize value to the government. It will be necessary on a nonrecourse basis to have credit enhanced and structured sales.

Auctioning nonstructural packages of loans, regardless of the underlying creditworthiness of those loans, will achieve only fire sale prices.

I would like to concentrate, Mr. Chairman, on the above three points: Of course, third-party servicing is available for a number of institutions, and, finally, we encourage the addition of the exemption of nonrecourse loan sale packages or pools from the Investment Company Act of 1940 requirements.

There are three categories of loan assets, as we see it. Some loan assets, in effect, are grants, really, or the default or delinquency rates are such that they become a modified grant program. For example, there are some programs of the Department of Agriculture which today have a delinquency rate of over 40 percent. These are not saleable on a nonrecourse basis. They might be saleable, however, with something known as loan substitution, which has been a technique used in the past in Federal credit backed issues in the early 1970's.

Chairman **Roth**. Describe exactly what loan substitutes are?

Mr. **Warner**. Yes, certainly. In Certificates of Beneficial Ownership, which are sold to the Federal Financing Bank today, which comprise blocks of FmHA assets or loans, there are typically three credit backstops for those certificates of beneficial ownership.

One backstop is that the underlying loans themselves are insured and have access to the revolving fund. The other key is substitution. That is to say that when a loan has become delinquent or has gone into default, then the Department of Agriculture or FmHA, in this case, will substitute the defaulted loan or delinquent loan with a new loan of reasonably comparable amount and maturity.

So that at all times, the loan assets which are bundled for sales to the Federal Financing Bank or CBO's are current. That is the way that the delinquency or default of loans is taken care of by FmHA in their CBO sales.

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[1] Mr. Warner's prepared statement may be found on p. 422.

[2] Mr. Snyder's prepared statement, with attachments, may be found on p. 432.

It could be possible to do the same in private sector sales also. But that of course, would not be pure nonrecourse.

I see my time is up.

Chairman ROTH. Go ahead. I asked you a question.

Mr. WARNER. A second category of loan asset is a loan asset which will not be defaulted upon but which clearly was intended to be modified during the term of the loan. For example, OMB has indicated that on foreign military sales that 55 percent of those loans which were made and which are guaranteed by the Department of Defense and which were sold to the Federal Financing Bank are then converted into grants.

So a program which generates loans which are intended to become grants as opposed to perhaps unintentionally becoming grants also is not a very good candidate for nonrecourse sales.

Then there is a third category of loan asset which, I am happy to say, is very large, and those are loans which are created by the agencies under their programs of very high credit quality. I singled out the Department of Agriculture for having some loan assets which have a delinquency rate of more than 40 percent.

I am happy to say that there are some Department of Agriculture assets which have a zero delinquency or default rate, certainly, default rate.

Those could be bundled and sold, and this is really the category of loan asset I think we should be focusing upon on a nonrecourse basis, or otherwise, it is fire sale prices.

Very briefly, I will just mention that in my view, it is the agencies which should have the primary responsibility, because they have the programmatic knowledge. OMB and Treasury should be consulted. Certainly, Treasury should be consulted in terms of the timing of sale and also passing on the fairness of the pricing. But Treasury has no experience in terms of structured sales or asset sales of the nature that we contemplate here in order to maximize value to the U.S. Government.

Finally, my third and final point I would like to discuss with you this afternoon. We are talking about the packaging of assets here. It has to be bulk packaging in size, it has to be credit enhanced and it has to be rated. If you put together a package of loans which have even a 0.02- or 1-percent default rate, and just say to the public, "Here, buy them," the results will be fire sale pricing.

Therefore, we recommend that assets be credited enhanced and structured. Those can only be done by a number of parties working together, and therefore, maximization of value also entails a negotiated as opposed to the auction method of sale.

Let me terminate, my summary by quoting, with approval, the testimony which you heard earlier from Senator Domenici this morning on the same bill. He said at the end of his testimony, that, "I urge the committee to develop guidelines for the sale of existing assets and to work as quickly as possible." After all, proceeds from asset sales are reflected in the budget, and it is time to get on with it.

We are fully confident, Mr. Chairman, that properly structured, and using the right mix of loans with the right programs, that the

Government will be able to maximize value and substantially reduce the Federal deficit.

Thank you.

Chairman ROTH. Thank you, Mr. Warner.

Mr. Snyder.

Mr. SNYDER. Good afternoon, Mr. Chairman. I am honored to have the opportunity to speak before you. I am president of Loan Pricing Corp. The perspective I am presenting for your consideration reflects Loan Pricing Corp.'s focus as a collector and provider of commercial loan pricing information. Our experiences may shed light on how to develop market prices for different forms of federal credit assistance.

The Loan Pricing Corp. provides banks and other organizations with competitive pricing information on the $500 billion worth of loans on the books in U.S. banks. Its funds are borrowed by more than 50,000 businesses.

To obtain pricing information, we conduct monthly pricing surveys among the banks, and we also rely on daily pricing information from the corporate bond market. Pricing data supports a loan pricing matrix, which provides prices for borrowers, segmented into 128 industry categories, 6 sales categories and 9 risk categories. Possibly a pricing tool like this could be applied to some classes of federally-assisted credit.

This new loan pricing matrix information helps bankers price loans more effectively. As it turns out, lenders and borrowers are not exactly on the same footing. Corporate treasurers, for example, shop around, and most of them have a pretty good idea of what the market price is for their loans before they sit down to negotiate.

The banker, on the other hand, is at a systematic relative disadvantage. The bank has no way to develop a clear notion of the market price for a loan to, say, a cement company with $70 million in sales and an average credit rating. So therefore, the banker must negotiate, hoping for the best price.

Deprived of market pricing information, our pricing data suggests that bankers are not particularly efficient pricers, that is, they submit widely different pricing for the standard loans that we send out for them to review.

This is not surprising, and it is also not surprising that corporate treasurers take advantage of bankers' lack of pricing information and pick through the banks, trying to find the lowest price.

Exhibit I in my prepared remarks illustrates the pricing range that Loan Pricing Corporation typically finds on commercial loans. To quote one bank, "We never know how much we leave on the table. They—that is, the treasurers—tell us how much we lose by, but they never tell us how much we win by."

There are several interesting and important changes that may be occurring in how business loans will be priced in the future. First, the availability of competitive market data like ours may help. Competitive market pricing may also give bankers a little more clout in dealing with treasurers or those who buy loans from the banks.

But the new proposed capital requirements in the federal reserve as proposed, coupled with worsening competition, are causing banks to experiment with selling loans in much the same way you are discussing today, and the possible future existence of secondary prices for corporate loans may have a wide-ranging impact on the primary loan prices, as well.

First of all, there may come to be a better alignment with bond prices. If bankers develop a secondary market for commercial loans, those who buy bonds may also buy the loans. This would cause a more efficient alignment between those two pricing patterns.

Bankers also have the possibility of developing more diversified or better diversified loan portfolios. An active secondary market will permit banks to unhinge the loan origination function from the loan portfolio function.

Mr. Clarke, the Controller of Currency, discussed these possibilities in another committee hearing in the building today.

These developments, in turn, may minimize the systemic problems that have contributed to some of the agriculture and energy bank problems.

Finally, the moral hazard issue. These possible changes raise important questions about the moral hazard involved when a bank or another lender sells a loan. However, the market mechanism may produce some very real incentives for a bank or other lender to avoid selling a bad loan and ruining their standing in the secondary market.

Broadly, both banks and the Government appear to be entering a period of asset liquidity management wherein all loans that can be sold will be.

Thank you very much.

Chairman ROTH. Thank you. Mr. Warner, in your testimony, you said the negotiated sales method, not the auction method, will maximize value to the government. Just exactly how does the negotiated sales method work?

Mr. WARNER. Well, the way I think we could envisage it working would be that the agencies involved would talk with a number of leading investment and commercial bankers and others, as appropriate, and then in consultation with OMB and Treasury, select a bank or bankers to work with them in creating the kind of packaging which responds to the underlying loan assets and the best structure for the marketing of those assets.

Then there would be elaborate marketing effort made, because after all, these loans that we are discussing here are nonrecourse. They have nothing to do with the Federal Government; the agencies may have originated them, but they are stepping aside. So these assets will be sold really on the basis of their rating. Their rating will be on the basis of their credit enhancement as put together with the bankers, again, through the negotiated basis, because to sell these just on an auction basis, as you can appreciate, would be without credit enhancement or structure, necessarily, or without that structure which maximizes value to the selling agency.

Chairman ROTH. How would you avoid allegations being in the political arena, that there wasn't politics in the negotiation of the products, in the whole process?

Mr. WARNER. It seems to me that there are a number of leading investment banks and commercial banks who have broad experience with mortgage-backed securities; with receivables financing; with structured asset sales. That would be the natural universe to be looking toward.

In a comprehensive response from those banks, I am sure you are going to see differences among them which reflect different levels of expertise, capital, risk-taking and so on.

I don't think that there could be substance for allegation of any kind of political influence here if one is dealing with a certain number of experienced bankers whose reputation is well known, and moreover, if the process is, as I suggest it should be, coordinated also with OMB and Treasury.

Chairman ROTH. I see we have another vote. I want to thank both of you for being here. I am sorry we kept you so late in the afternoon. Your testimony has been most helpful.

Mr. WARNER. Thank you.

Chairman ROTH. The committee is in recess.

[Whereupon, at 5:06 p.m., the committee was recessed to reconvene at 3:05 p.m. on May 14, 1986.]

FEDERAL MANAGEMENT REORGANIZATION, COST CONTROL, AND LOAN ACCOUNTING REFORM

WEDNESDAY, MAY 14, 1986

U.S. SENATE,
COMMITTEE ON GOVERNMENTAL AFFAIRS,
Washington, DC.

The committee met, pursuant to recess, at 3:05 p.m., in room SD-342, Dirksen Senate Office Building, Hon. William V. Roth, Jr., (chairman of the committee) presiding.

Present: Senators Roth, Cohen, and Eagleton.

OPENING STATEMENT OF CHAIRMAN ROTH

Chairman ROTH. The committee will please be in order.

We are reconvened today to hear testimony on the Federal Management Reorganization and Cost Control Act. This bill is an omnibus effort to reorganize and reenergize the President's capacity to develop and encourage more effective management throughout the Government. This bill will also put in place vitally needed reforms in Governmentwide management systems for accounting, financial reporting, and for cash, credit, and debt collection management, and also for information resources management.

It has been suggested that the organization of the Executive Office is uniquely a responsibility of the President, and, of course, the President does have a very special interest in the organization of his own house.

The Congress, too, has a special and longstanding interest here, to make certain that the President has the necessary tools to enforce the law. After all, it was the Congress that passed legislation creating the Bureau of the Budget in the first place, and later enacted legislation making possible the creation of the Executive Office of the President.

Now many of us in Congress who are most concerned with the performance of Federal management are intent on providing the President with the necessary tools to get the job done. S. 2230 establishes an Office of Federal Management to advise and assist the President on a wide range of management functions, including managerial leadership, procurement and property management, information and statistical policy, regulatory affairs, organization planning and analysis, and legislative review.

This bill also locates definite responsibility for financial management in the Office of Federal Management, designating an administrator for financial systems with authority—clout—to make certain that, finally, the agencies will have adequate accounting and financial reporting systems.

The Office of Management and Budget is now the only location in Government with overall policy-setting authority for all the management areas. While management may be alive in OMB, it is certainly not well there.

You haven't been there too long, so you don't have to take that personally, Mr. Miller.

Witness after witness before this committee yesterday testified that effective Federal management has not, is not, and probably never will be emphasized in the Executive Office of the President within the existing organizational framework.

Comptroller General Charles Bowsher said here yesterday that he is convinced that the management job "will never get done at OMB." The original concept, as he pointed out, "was to tie management improvement to the budget," but "what we have really seen over the years is the budget people literally attacking the efforts to improve * * * management," which "is just the opposite of what the people who put the OMB concept together wanted."

The Executive Director of the Ash Council, which put together the OMB concept, testified here yesterday that, and I quote, "The management function, despite administration denials, has never become a significant force at OMB." In his view, had the Ash Council had better foresight, it would have recommended a separate Office of Federal Management similar to the one now established in title I of S. 2230.

I think that we can all appreciate the potential importance of connecting management improvements with the budget process as a means of ensuring savings and of exercising the clout to get things done, to make certain that management improvements are accomplished. The administration and the current Director of OMB are to be praised for their efforts in this direction.

But management means more than just ratcheting down expenditures. We need to find and develop leadership for effective management Governmentwide to organize Government for streamlined, full-performance service delivery, and to put in place and continue to upgrade modern systems for financial management, and for the management of information and records.

Only the President can offer the overall managerial policy leadership that is necessary in these areas, but to provide that leadership, the President, and the Presidency, needs help. By this, I mean the sustained institutional resources to do the job, to make sure that the President's management policy objectives are implemented, to provide an institutional memory of what has gone on before, and to make certain that there is a sustained capacity to assist agencies with excellence in management, not just in one Presidential administration with a special study or project.

Senator Cohen, would you like to make an opening statement?

OPENING STATEMENT OF SENATOR COHEN

Senator **Cohen**. Mr. Chairman, I would like to make a few opening remarks. I have an Intelligence Committee meeting to go to, and I am not able to stay through the presentation of Mr. Miller.

First, I would commend you for taking this initiative and proposing legislation that would strengthen the management function of the Federal Government. I will not read my entire statement, but just raise a couple of questions that I do have.

For example, in title V, you are intending to reform Federal loan programs by having an application fee, and certain other provisions, which I am afraid would have a serious impact upon the farmers that I represent, some of the small business people, students, and low-income families that these programs generally are intended to help.

The requirement for a loan origination application fee, in particular, strikes me as somewhat contrary to the very spirit and intent of the programs themselves. They are largely directed toward people who either are not eligible for or can't afford the cost of a loan from a bank or a savings and loan institution, and if we saddle them with the upfront costs, it seems to me that it is going to defeat the purpose of having the programs in the first place.

The potential impact on the Farmers Home Administration's rural housing program, I think, will illustrate the problem. The average borrower of FmHA funds, under the section 202 program, is very close to the poverty line, with very little, if any, savings. The question is how would such an individual be able to pay the hundreds, perhaps thousands of dollars in points and application fees to get this loan in the first place?

There is also a provision in your proposed bill, which I generally support, that would require agencies to set debt collection targets. Each agency head would have to set a debt collection target, and if the agency failed to collect those debts, then the program budget would be reduced accordingly. It seems to me you could have an individual who might not support a particular program and would set an unrealistically high debt collection target, fail to meet that debt collection target, and thereby succeed in reducing the budget. I would not suggest that this would be done with malevolence or direct intent, but it could happen.

So I have a series of questions about how these provisions would actually operate and how we could protect the very people that we are trying to help through these loan programs.

But I would say that I think your bill is, overall, a good piece of legislation. Assuming these questions that I do have, and perhaps some others, are resolved, I do intend to support your bill.

[Senator Cohen's prepared statement follows:]

PREPARED STATEMENT OF SENATOR COHEN

Mr. Chairman, I commend you for taking the initiative in proposing legislation to strengthen the management of the federal government. Many of the provisions of your bill will make long overdue improvements in federal systems for cash management, accounting, and internal controls.

I do, however, have some reservations about certain provisions in Title V that are intended to reform federal loan programs. While the goal of these provisions is certainly laudatory, I am concerned about their impact on the farmers, small business people, students, and low-income families that these programs serve.

The requirement for loan origination and application fees, in particular, strikes me as contrary to the very purpose of many federal loan programs. These programs largely serve people who either are not eligible for or cannot afford the cost of a loan from a bank or savings and loan institution. To saddle them with up-front costs would defeat the purpose of providing them with federally subsidized loans.

The potential impact on the Farmers Home Administration's rural housing program illustrates the problems with charging applicants loan origination and application fees. The average borrower of FmHA funds under the Section 502 program has an income close to the poverty line, with little or no savings. How is such an individual going to be able to pay hundreds, perhaps thousands, of dollars in points and application fees to get an FmHA loan?

This provision is also troubling because it links the amount of the fees to the administrative costs of the program as well as the costs of defaulted loans. This means that a potato farmer in Maine applying for a loan from the Farmers Home Administration would be charged a fee to help defray the costs of the massive farm foreclosures in the Midwest.

Requiring new applicants to pay fees to cover the costs of defaulted loans easily could translate into prohibitive up-front costs for the very people these programs are supposed to help.

As we seek to improve the management of the federl government, we should keep in mind that the government is not a private corporation. What may make sense for a large corporation may not always make sense for the federal government. In our quest for efficiency, we must not lose sight of the reasons why we enacted certain federal programs in the first place.

Mr. Chairman, I believe there is a great deal of merit in much of your bill, and I look forward to working with you on amendments to meet the concerns I have raised today.

Chairman ROTH. Senator Cohen, I appreciate your comments. Obviously, this is a first draft. There will be a markup. There are, I am sure, many areas that can be refined and improved upon. We look forward to working with you on the issues you've raised.

Mr. Miller, we are always delighted to have you here. You can read your statement, or summarize it; in any event, the entire statement will be included as if read.

TESTIMONY OF JAMES C. MILLER III, DIRECTOR, OFFICE OF MANAGEMENT AND BUDGET,[1] ACCOMPANIED BY JOSEPH R. WRIGHT, DEPUTY DIRECTOR, AND CAROLE J. DINEEN, ASSOCIATE DIRECTOR FOR MANAGEMENT

Mr. MILLER. Thank you, Mr. Chairman, I will take your offer of trying to summarize it, rather than reading the entire thing.

As you know, I have a keen interest in improving the management of the Federal Government, and in controlling costs, and I believe that we can do no less in deference to the millions of American taxpayers who foot the bill for what the Government does.

I also know that you share these goals. You have told me privately and publicly. You drafted S. 2230, the Federal Management Reorganization and Cost Control Act of 1986, and you scheduled this hearing. Thus, I want to state clearly up front that in my mind we don't disagree over the goals that should be achieved. What reservations I will express today, orally or in my prepared statement, go to the means for achieving these goals.

Let me begin by making three points that I think transcend all of the others contained in my written statement.

The first is that I believe Congress should be very reluctant to dictate to any President how he or she organizes their immediate office, and just what functions those component parts play. The reasons are several.

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[1] Mr. Miller's prepared statement may be found on p. 438.

First, there would seem to be a constitutional issue of just how far Congress can go in making the determinations that, in effect, have a tendency to micromanage the President's Executive Office.

Second, in the same spirit, consider the nature of this by putting the shoe on the other foot. To what extent would you think it appropriate for the President to try to dictate how Congress runs its own affairs, its own rules of the Senate, its own rules of the House, et cetera.

Third, while the Executive Office is always going to carry out certain functions, more than any other place in Government, the Executive Office must reflect and be compatible with the style, the priorities, and the proclivities of the Chief Executive. To deny him or her that flexibility would be to limit the ability of that universally elected official to carry out whatever commitments they had made to the electorate.

Of course, I realize that the system we have now is a mixed one—some congressional specificity—for example, my own office, as you pointed out, established in 1921 as the Bureau of the Budget, in the Treasury Department—together with a great deal of flexibility. I think that it is a pretty good arrangement.

It seems to me that, at least, a weighty burden of proof lies on those who would mandate specific means of achieving objectives when those means involve intrusion in what basically seems to me, in the words that you used earlier, Mr. Chairman, a uniquely Presidential responsibility.

The second major point I would like to make is that, while it is possible to conceptualize there being a distinct difference between management and budget functions, in practice they go hand in hand.

Let me pose a series of propositions, all of which, I think, you will agree are basically correct.

First, the budget is a means of carrying out management decisions.

Second, good management depends on having good budget information.

Third, there are important synergistic effects in bringing together management experts and budget experts.

In amplification of these points, let me suggest a reading of the address that I gave, attached to my prepared remarks, dated April 4, to the American Association for Budget and Program Analysts, which is entitled: "Putting the M in OMB." [1]

With all due respect to this draft legislation, I must confess I would have great difficulty running the proposed Office of Federal Budget, without having some management orientation, without management expertise at my hand, and without a modicum of management authority. Even more difficult would be heading the proposed Office of Federal Management, without having budget authority to carry out those management decisions.

In fact, one thing I am sure of is that if you divide the budget and management functions into separate agencies, it will be management that will suffer the most, although I think the effectiveness of both sides would diminish.

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[1] Mr. Miller's prepared remarks before the American Association for Budget and Program Analysts may be found on p. 446.

Let me put it this way. Which occupies the lion's share of your attention? I would vouch that it was most probably issues dealing with the budget, rather than the management of the agencies. But I think that it is important that the same people are able to look at the same issues.

As the speech that I mentioned before attests, I have made coordination and integration of budget and management efforts at OMB a major goal. Management people participate in formal budget reviews. Management issues are raised at budget hearings with the agencies. Budget people help formulate questions for management people in the formal management reviews of agencies. Budget people provide great expertise and other help to management efforts, particularly reviews of paperwork requirements and regulations.

This raises, of course, the third major point I would like to make, and that is the need to reauthorize the Office of Information and Regulatory Affairs [OIRA] with respect to its appropriation.

As you know, OIRA has not been reauthorized for several years. As you also know, the administration strongly supports reauthorization of OIRA. In fact, I stressed this point publicly before this committee on several occasions, including my confirmation hearing. I have expressed similar sentiments to you privately, and to your colleagues in the other body.

I realize that title VI of S. 2230 addresses this issue, but I believe that time is of the essence—if I may use a lawyer's term—inasmuch as markup of OMB's appropriation is imminent both in this body and in the House. Thus, I strongly urge you to address this issue in a stand-alone bill, patterned after S. 2433, which was endorsed unanimously by this committee, with strong administration support, during the last Congress.

Let me assure you, Mr. Chairman and members of the committee, we, in the administration, stand ready to aid you in accomplishing the goal of reauthorization of OIRA.

In conclusion, let me stress our commitment to make further improvements in the management of the Federal Government. We both share this goal, and I will submit that the best means for accomplishing it is to put the M in OMB, and to keep it there.

Mr. Chairman, I think you are absolutely right, we have more work to do, things are not perfect, they are not complete. Our reforms are not the last answer. We have to do more work, there is no question about that. We want to work with you on S. 2230, and other proposals to reform and strengthen our and the agencies' efforts.

One of the things that I think is important, as much as I would like to be a czar of all the government, I don't think the OMB can really micromanage all of the agencies. I think that we have to play an important role as a catalyst in getting the agencies to do the appropriate thing, to improve their management techniques, to improve credit management, and to improve financial management. But OMB cannot direct this out of the Executive Office of the President. I don't think that that would be the appropriate expenditure of resources in the Executive Office of the President.

As you can see from my prepared remarks, I have serious reservations about a number of provisions in the bill. On the other hand, there are some provisions with great promise, and others where I think that a slight change would more fully accomplish the stated or implied objective.

Mr. Chairman and members of the committee, as you know, the budget resolution is now being debated on the floor of the other body, and my latest count is that we are behind, which may be an understatement.

Pursuant to an understanding that we have with your staff, I would beg permission to leave, or stay for just a couple of questions. Joe Wright, my able Deputy, Carole Dineen, my Associate Director for Management, and Wendy Gramm, who is the Administrator for the Office of Information and Regulatory Affairs, are here, and they will be happy to address any other questions that you have.

Chairman ROTH. Let me just make one comment, Mr. Miller. I sympathize with your problem, and yet in a very real way it demonstrates the problem we have that budget seems necessarily to be the primary concern, and management second.

I agree with you that part of the problem is over here in the Congress. One of the reasons that OMB is budget driven, as they say, is properly found in the Congress. But my concern, Mr. Miller, is that management is taking a backseat—it is taking a backseat within the agency, and really there have been no major initiatives to improve the efficiency of Government from the management point of view.

One of the things that came out very clearly yesterday is that the original hope that putting budget and management together would give some clout to management, to use an expression of Senator Eagleton, just hasn't worked that way.

So what we are seeking is some effort, not to inhibit the discretion and the initiatives of the President, but to create some kind of institutional backing that will make management a more important factor.

Right now, it seems to me, one of the key questions facing this Government is how to move into the 21st century of computers and software, and I don't think that there is much direction being given from anywhere. Just one small example, I am not going to ask any questions right now, but I am going to give an opportunity first, to, Senator Cohen, and then to Senator Eagleton.

Senator COHEN. Just one or two quick questions, Mr. Miller.

Mr. MILLER. Could I just respond, Senator, to the point that the chairman raised?

You are absolutely right, it is very difficult to get away from the in-box mentality. You get a call from a Senator about some budget issue, or you have something coming up on the floor, or you have some document that you must produce. You have a letter from someone in the private sector that you must answer. These things tend to crowd out the broader issues. Frankly, it may sound like heresy, but I think management issues are harder to think about. They require more concentrated effort, because you have to conceptualize the problem and how to deal with it and you don't have a checklist of things that have to be done. So I think you are right.

I have tried to spend more time on management than some of my predecessors. We have made some progress. I am not satisfied with what we have done so far. I think we can make some substantial additional improvements. However, I do think that if you set up a separate Federal Management Office it would get lost in the Executive Office of the President.

While I wouldn't be here by the time the separation took place, I think that I can step back enough to view it objectively. Based on my observation of several Presidents, I think management issues would get lost.

In a way, when you look at the Ash Council recommendation and the great expectations for putting management and budget together to give management some clout, I think you are looking at a generic problem with human nature, and I don't think that a restructuring will solve it.

I agree with your objective, and, if there is something that you can put in legislation that permanently raises or heightens awareness of the need for better management, we ought to do that. I will be glad to work with you in trying to figure out how to do that, while at the same time minimizing intrusion into the President's province.

Chairman ROTH. Senator Cohen.

Senator COHEN. Thank you, Mr. Chairman.

If I were to take a survey of the people in this room and mentioned the letters OFPP, I doubt whether 10 people would know what I meant. But OFPP—the Office of Federal Procurement Policy—is something that has been very important to members of this particular committee and I know to you, Mr. Miller. Under the proposed bill, the Office of Federal Procurement Policy would be transferred to the Office of Federal Management.

During your confirmation proceedings, you indicated at that time that you were very much looking forward to getting an Administrator for OFPP. In February, Senator Chiles and I raised the issue again as to what has happened to the Administrator for OFPP. Here we still are even today with no Administrator, and a lack of leadership which I think, at that level, is very important to the agency. Can you tell us what you have done?

Mr. MILLER. Yes, I will be glad to. Without taking anything away from the Acting Director of OFPP, Mr. Baker, I want to say that I have chosen a person in my own mind to recommend to the President, and that person is undergoing some review.

Senator COHEN. Just one other quick question. I would just point out that the loan origination fees required by this legislation might end up possibly costing the Government more money, rather than less.

The Farmers Home Administration's section 202 program for rural housing requires that 40 percent of the moneys go to low-income families. If you have an origination or application fee, which these folks can't meet, and 40 percent of the budget is allocated for their needs, you might end up with a situation where Farmers Home has to roll the origination fee or the application fee into the actual loan, thereby increasing the Federal Government's potential liability. That is another issue that we have to look at, I believe.

Chairman ROTH. Senator Eagleton.

Senator EAGLETON. I will be brief because I understand Mr. Miller has to be on the House side, and I appreciate that fact.

I share, in part, Mr. Miller, some of your apprehension that an Office of Federal Management in, and of, and by itself might get lost, or, as I stated in the other hearing yesterday, might be so without clout that it would be politically and governmentally impotent.

You mentioned that Congress spends the lion's share of its time worrying, studying about, and fretting about the budget insofar as your department is concerned. How is your time allocated, as between Budget and Management?

Mr. MILLER. The same way, more on the budget side than on the management side, there is no question.

Senator EAGLETON. Way, way, way more on the budget side.

Mr. MILLER. Well, Senator, in the context of the definition of management that I gave in my paper, "Putting the M in OMB," where I talk about policy decisions really being management decisions, I wouldn't say that it is way, way more. I do spend more, time on budget issues but it is not way, way more, when you think about how Government should be organized.

One of the management issues that I wake up in a cold sweat about is the *Chadha* decision and its progeny. We have got to think about how to deal with things like the reporting and accounting relationships among executive agencies, independent commissions, and GAO.

I don't have answers to these problems and I think that a lot is going to depend on what the courts say. Issues like this occupy my time, and I count them as management.

Senator EAGLETON. One benchmark would be your immediate predecessor. Without getting into the more controversial parts of his book—I have read it—I would say that less than one page is devoted to management. Everything else, putting aside personalities and politics, et cetera, is devoted to the budget.

He was in office for 4 or 5 years, and in writing about that period of time, precious little of his book is devoted to management. Almost all of it is devoted to the budget. I think that that reflects the frustration that Senator Roth feels, and that has generated this legislation.

One final question. You stated in your remarks, putting aside again the constitutional issue, that a lot depends on the style and proclivities of a given President. Accounting systems, financial systems, management systems, that is not style or proclivities.

Mr. MILLER. I agree.

Senator EAGLETON. If we are focusing on good management procedures, good auditing procedures, good reporting procedures that ought to be a continuum from one Presidency to another, regardless of the political party, style, or what have you; correct?

Mr. MILLER. There is obviously a balance. When I wrote those words, I was struggling with the very idea you have, because your ideas are right. Whoever the President might be, he needs to make sure that the Government keeps its books in order, that it manages the credit portfolio of the Government in an intelligent way, that it does have financial accountability by the agencies. Those functions need to be carried out, but precisely how they would be organized, how the leadership of those activities would be organized within the Executive Office of the President is something to be determined by the President. I think we really owe him that flexibility.

Senator EAGLETON. Thank you very much.

Chairman ROTH. Let me just ask you one final question, and then we will let you go.

You propose that we keep the M in OMB. I sort of hoped that you would come forward and be the first public servant to come forward and propose the dismantling of his organization, but we will have to wait another day for that, I guess.

Mr. MILLER. You can take deregulation too far, Mr. Chairman. [General laughter.]

Chairman ROTH. What could be done to strengthen management, to institutionalize the M in OMB? In the many years that I have served here, no head of OMB really has paid that much attention to management because the budget has been the thing.

Mr. MILLER. Yes.

Chairman ROTH. You see, this is critically important, and everybody ignores it, including the Congress, because management is hard to discuss, hard to comprehend, and hard to legislate. Yet, when you go back to talking about the Presidency, what we are really trying to do is to give him the tools to work with, not influence how he functions, but to insure that he has accurate, up-to-date, modern information. The fact is that everybody knows that the Government organization is anything but what it should be. How do we deal with that problem if we don't move ahead with my proposal?

Mr. MILLER. I think you have the genesis in your draft of some ideas. Some regimentation, I think, is a good idea. For example, requirements for a management report to Congress, without being too specific about the contents, would be acceptable. You wouldn't want to confine the head of OMB in terms of the precise subjects that he must report on, which could stultify the imagination, to some degree, because he might want to include some different items.

As you know, this year, the President sent up the management report. We released it at the same time that the budget was released, and for the first time the President had a message in the management report.

Chairman ROTH. Could I interrupt because I want to give one specific example to illustrate what I mean.

For years, the Congress and the GAO have tried to institute a consistent accounting procedure throughout Government, since 1950, and now it is only 36 years later, and it hasn't happened.

How can we get the clout or the capability, somewhere in Government to do this? I am not wed necessarily to do one particular approach, but I am wed to the idea that we have got to make Government more effective.

Let's assume that we wanted to legislate something in this area, what can we do to insure that every branch of Government, or every agency within the executive branch of Government has the same basic accounting procedures?

Mr. MILLER. If you wanted to accomplish that universally, you could legislate reports, and you could establish authorities for organizations.

I have looked into it and I have talked to people enough to question whether there should be universal accounting systems. Some agencies are sufficiently different, that the advantages of commonality may be offset by the disadvantages of collecting information in a form that is really not usable.

Chairman ROTH. You agree that there should be accounting standards, common accounting standards in the various agencies of Government?

Mr. MILLER. I understand, honesty, integrity, and those kinds of things, are standards we all agree with. When it comes down to great specificity about how you treat certain kinds of assets, or certain kinds of liabilities, there may be differences.

Chairman ROTH. These standards have already been mandated by law. What is bothering me about what you are saying is, really, each agency should go its own way, and I think that this has been the problem.

Mr. MILLER. I don't mean that. What I am suggesting is that there may be occasions where you would purposely want to have a slightly different set of standards or procedures for one agency than for another, the reason being that the agencies do differ. But I agree that there is not, at present, the commonality, or the degree of commonality that is appropriate. In fact, we are working on that right now.

On another subject, you mentioned computers a few minutes ago. One of the tough things that we have to deal with is getting appropriations approved which would permit standardization of software and hardware. As you know, those have been on-again, off-again kinds of things. Cutting capital assets such as computers is an easy way for an agency to put off expenditures.

I don't want to blame Congress, but in the process of putting together the budget, when an agency is faced with the need to cut back, frequently computers are one of the first things that they can cut back because they can let that slide.

The appropriations process makes it difficult to have an overall process, a standardized hardware, or a standardized interface among machines.

In addition, we are looking right now at a capital budget and various measurement techniques. Right now, if you buy a computer that lasts for 10 years, we charge that off, and we score that computer in 1 year. This does lead in some instances to biases in decisionmaking.

Chairman ROTH. Let me ask this question. Would it help to mandate management functions to OMB in legislation?

Mr. MILLER. Would it be useful to mandate management functions?

Chairman ROTH. Yes; would it really make any difference?

Mr. MILLER. I think that it probably would, if I understand what you are saying.

Chairman ROTH. I am going to let you go because I know you do have important business. At the same time, except for this committee, I don't think that too many people over here take much interest in management. I am not satisfied with what is going on. I am really not trying to talk about your stewardship because you have been in there for a very short time. But every time that anybody comes up here for your job, we raise this question, and they always assure me that, yes, they are going to take great interest in it, and 2 years, 3 years, 5 years, whatever it is, there is no change.

We are going to move ahead. We are going to have legislation proposed, and we want to work with the administration in this area. So I would hope that you and the others would take this initiative seriously.

Thank you Mr. Miller. We look forward to seeing you again.

I think that what we would prefer to do, rather than proceed, Mr. Miller, is to submit a number of questions in writing, and we would ask that they be returned within 10 days.[1]

Mr. **Miller**. We will be glad to do that.

Chairman **Roth**. Thank you, Mr. Miller.

Mr. **Miller**. Thank you very much.

Chairman **Roth**. The committee is in recess.

[Whereupon, at 3:41 p.m., the committee recessed, to reconvene at the call of the Chair.]

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[1] See p. 453.

ADDITIONAL MATERIAL SUBMITTED FOR THE RECORD

99TH CONGRESS
2D SESSION

S. 2230

To improve the management of the Government by establishing an Office of Federal Management in the Executive Office of the President, and for other purposes.

IN THE SENATE OF THE UNITED STATES

MARCH 26 (legislative day, MARCH 18), 1986

Mr. ROTH introduced the following bill; which was read twice and referred to the Committee on Governmental Affairs

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A BILL

To improve the management of the Government by establishing an Office of Federal Management in the Executive Office of the President, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That this Act may be cited as the "Federal Management Reorganization and Cost Control Act of 1986".

TITLE I—IMPROVING FEDERAL MANAGEMENT

PART A—ESTABLISHMENT OF OFFICE OF FEDERAL MANAGEMENT

PURPOSE

SEC. 101. In order to strengthen the overall management of the Federal Government, reform and improve the Government's financial systems, foster economy and efficiency, establish more effective systems and structures for Government programs, improve the executive leadership of Federal departments and agencies, and build the capacity of such departments and agencies to carry out their missions, this title (1) establishes an Office of Federal Management in the Executive Office of the President, (2) within that Office, establishes an Office of Financial systems, (3) establishes controllers within executive departments and agencies with responsibilities parallel to the Administrator of the Office of Financial Systems, (4) provides for the transfer of appropriate functions of the Director of the Office of Management and Budget to the Office of Federal Management, (5) redesignates the Office of Management and Budget as the Office of Federal Budget, and (6) requires the President to submit an annual management report.

ESTABLISHMENT OF OFFICE

SEC. 102. (a) Subtitle I of title 31, United States Code, is amended by adding at the end thereof the following new chapter:

"CHAPTER 9—OFFICE OF FEDERAL MANAGEMENT

"SUBCHAPTER I—ESTABLISHMENT

"Sec.
"901. Office of Federal Management.
"902. Officers.
"903. Functions of the Director.
"904. Employees.
"905. Necessary expenditures.
"906. Regulations.
"907. Definition.

"SUBCHAPTER II—OFFICE OF FINANCIAL SYSTEMS

"911. Office of Financial Systems.
"912. Administrator.
"913. Functions of the Administrator of the Office of Financial Systems.
"914. Regulations.

"SUBCHAPTER III—AGENCY CONTROLLERS

"921. Appointment.
"922. Functions.

"SUBCHAPTER I—ESTABLISHMENT

"§ 901. Office of Federal Management

"(a) The Office of Federal Management is an office in the Executive Office of the President.

"(b) The Office of Federal Management is composed of—

"(1) the Office of Information and Regulatory Affairs established under section 3503 of title 44;

"(2) the Office of Federal Procurement Policy established under section 5(a) of the Office of Federal Procurement Policy Act (41 U.S.C. 404(a)); and

"(3) the Office of Financial Systems established under subchapter II of this chapter.

"§ 902. Officers

"(a) The head of the Office of Federal Management is the Director of the Office of Federal Management. The Director is appointed by the President, by and with the advice and consent of the Senate. The Director shall be the principal advisor to the President on the management of the Federal Government. Under the direction of the President, the Director shall administer the Office.

"(b) The Office has a Deputy Director of the Office of Federal Management, appointed by the President, by and with the advice and consent of the Senate. The Deputy Director—

"(1) shall carry out the duties and powers prescribed by the Director; and

"(2) acts as the Director when the Director is absent or unable to serve or when the office of Director is vacant.

"(c) The Office has 5 Associate Directors who shall carry out the duties and powers prescribed by the Director.

"(d) The Office may have not more than 6 additional officers, each of whom is appointed in the competitive service by the Director, with the approval of the President. Each additional officer shall carry out the duties and powers prescribed by the Director. The Director shall specify the title of each officer.

"(e) When the Director and the Deputy Director are absent or unable to serve or when the Offices of the Director and Deputy Director are vacant, the President may designate an officer of the Office to act as Director.

"§ 903. Functions of the Director

"(a) The Director shall—

"(1) provide overall leadership in the development and implementation of Federal management policies and in the coordination of programs to improve the quality and performance of managerial personnel;

"(2) assist the President in carrying out the responsibilities of the President as Chief Executive Officer of the Government;

"(3) provide central policy direction and leadership in general management and managerial systems, procurement policy, grants and contracts management, financial systems, information and statistical policy, regulatory affairs, property management, and in other management functions, including organizational planning and analysis, human resources planning, and legislative review;

"(4) inform Congress and the public concerning the state of Federal management and concerning imperatives for more effective management;

"(5) facilitate actions by Congress and the executive branch to improve Government operations and to remove impediments to effective administration;

"(6) provide leadership in management innovation through experimentation, testing, and demonstration programs, and through the adoption of modern management concepts and technologies;

"(7) maintain continuous oversight of the organizational structures and managerial systems and processes of the Government, and recommend changes in such structures, systems, and processes;

"(8) promulgate goals to, and assist in the development and implementation of plans to, improve the productivity of Government personnel in program performance and in the delivery of Federal services;

"(9) advise the President on—

"(A) the requirements for providing executive leadership for the executive branch; and

"(B) the managerial requirements of positions filled by appointment by the President and on the relevant qualifications of candidates for such positions; and

"(10) work with State and local governments to strengthen the Federal system and provide assistance to such governments with respect to intergovernmental programs and cooperative arrangements.

"(b) The general management improvement and evaluation functions of the Director shall include—

"(1) the periodic assessment of the management performance of executive agencies, and recommendations to agency and organization heads and to the President on needed corrections and improvements;

"(2) conducting, in cooperation with executive agencies, management research, systems development, and demonstration projects, and to provide assistance to executive agencies in establishing new programs and organizations;

"(3) providing guidance and assistance to executive agencies in developing common automated systems to provide the President and the agency heads with timely, compatible, and accurate management information;

"(4) establishing uniform policies, guidelines, definitions, and reporting requirements for the evaluation of Federal programs and activities; and

"(5) providing guidance on, and monitoring agency efforts to implement, sound internal control systems as required under subsections (b) and (c) of section 3512 of this title.

"(c) The human resources management functions of the Director shall include—

"(1) advising the President on the managerial requirements of executive agency positions to which Presidential appointments are made and on managerial qualifications of potential nominees to such positions;

"(2) reporting to the President on pay and benefit levels for executive level positions in the Federal Government appropriate to recruiting and retaining highly qualified administrators and managers;

"(3) advising the Office of Personnel Management and executive agencies on the development of planning systems for effective workforce management and on the improvement of the quality and availability of data on human resource activities of the Government; and

"(4) developing, in coordination with the Directors of the Office of Federal Budget and the Office of Personnel Management, Governmentwide policies for pay, benefits, and labor-management relations, and of integrated personnel and payroll systems which meet categorical needs while responding to the circumstances of individual agencies.

"(d) The productivity improvement functions of the Director shall include—

"(1) developing and promulgating goals, principles, guidelines, and standards for the administration of an effective productivity improvement program for the executive agencies;

"(2) identifying and proposing the elimination of statutory barriers that inhibit opportunities to make improvements in productivity;

"(3) developing, in consultation with the agencies, organizational performance standards for those common Government and common agency functions that are appropriate targets for improved quality, timeliness, and efficiency;

"(4) assisting in the development of a productivity improvement plan for each executive agency, and reviewing each agency's productivity plan, based upon the requirements and guidance issued pursuant to this section; and

"(5) reporting annually to the Congress, in conjunction with the budget submitted by the President under section 1105 of this title, on the state of productivity plans and accomplishments of the agencies and the Government as a whole.

"(e) The organization and coordination functions of the Director shall include—

"(1) reviewing Governmentwide organizational structure on a continuous basis, periodic reporting to the President on the state of Government organization and of proposals to improve the performance and efficiency of Federal programs;

"(2) overseeing the overall operations and management of Government corporations and other Government-sponsored enterprises;

"(3) facilitating interagency cooperation in the field, and assisting in developing effective coordinating mechanisms throughout the Government;

"(4) overseeing intergovernmental administration, and grants management systems and techniques;

"(5) overseeing Governmentwide policies on (A) privatization of Government programs, services, and facilities, (B) administration of contracts between Government agencies and private parties, and (C) other relationships between the Government and the private sector; and

"(6) oversight of Governmentwide travel and travel services management.

"(f) The Director shall provide assistance in developing the President's legislative program by drawing together and reviewing all agency proposals for legislation and agency reactions to proposed legislation.

"§ 904. Employees

"The Director of the Office of Federal Management shall appoint and fix the pay of employees of the Office under regulations prescribed by the President.

"§ 905. Necessary expenditures

"The Director of the Office of Federal Management may make necessary expenditures for the Office under regulations prescribed by the President.

"§ 906. Regulations

"In the exercise of functions under this chapter, the Director of the Office of Federal Management shall be subject to subsections (b), (c), and (d) of section 553 of title 5, notwithstanding subsection (a) of such section.

"§ 907. Definition

"For purposes of this title, the term 'financial management' means all systems, controls, policies, and procedures of an executive agency which—

"(1) plan, account for, document, and report on financial performance and control of resources; and

"(2) promote economical and efficient use of financial resources such as financial planning, budget execution, accounting, financial information systems development and maintenance, financial analysis, debt and credit management, cash management and analysis, inventory and property management, and financial reporting.

"SUBCHAPTER II—OFFICE OF FINANCIAL SYSTEMS

"§ 911. Office of Financial Systems

"The Office of Financial Systems is an office in the Office of Federal Management.

"§ 912. Administrator

"(a) The head of the Office of Financial Systems is the Administrator. The Administrator is appointed by the President, by and with the advice and consent of the Senate, and shall be an individual of high personal integrity with demonstrated ability in accounting, budget execution, financial and management analysis, auditing, systems development and implementation, financial reporting, and public administration.

"(b) The Administrator shall be the principal advisor to the President and the Director with respect to Federal financial management policy.

"(c) The Administrator shall be appointed for a term of 4 years, coinciding with the term of the President. The Administrator may be removed from office by the President prior to the expiration of such term for permanent disability, inefficiency, incompetence, neglect of duty, malfeasance, or a felony or conduct involving moral turpitude. The President shall communicate the reasons for removal to both Houses of Congress.

"§ 913. Functions of the Administrator of the Office of Financial Systems

"(a) The Administrator of the Office of Financial Systems shall—

"(1) provide leadership, direction, guidance, and monitoring of the Government's financial management systems;

"(2) advise the President, the Congress, the Director, and agency heads on financial management matters and on the status of financial management in the Government;

"(3) establish policies for agencies, in conjunction with the Secretary of the Treasury and in consultation with the Comptroller General, and provide guidance for agencies, relating to financial management matters, including—

"(A) policies prescribing the overall objectives, structure, and information requirements for the financial management systems of the Government;

"(B) accounting policies and procedures which implement the Comptroller General's accounting principles, standards, and requirements prescribed under section 3511 of this title;

"(C) policies and procedures for the design and implementation of new or enhanced financial management systems;

"(D) policies and procedures to implement the internal control standards required by law;

"(E) policies for agency financial operations;

"(F) policies and procedures for agency asset management, including cash management, credit management, debt collection, and inventory and property management and control; and

"(G) policies and procedures for financial reporting which conform with the accounting principles, standards, and requirements of the Comptroller General;

"(4) develop and annually revise the five-year financial management plan required by subsection (c) of this section;

"(5) coordinate and monitor the activities and operations of the agency controllers appointed under subchapter III of this chapter in order to ensure that—

"(A) such controllers comply with—

"(i) policies and procedures established by the Administrator;

"(ii) accounting principles, standards, and requirements and internal control standards of the Comptroller General; and

"(iii) all provisions of law governing financial management;

"(B) adequate financial management systems have been established in agencies and are operating effectively; and

"(C) such systems and controls meet the needs of agency managers for internal controls and financial information;

"(6) review agency financial management plans and policies in order to assure that—

"(A) such plans and policies are—

"(i) consistent with the overall objectives, structure, and information requirements of Government financial management systems established under paragraph (3)(A) of this subsection; and

"(ii) applied uniformly across the agencies to assure parity and consistency; and

"(B) in the case of any project for the development of new or improved financial management systems, such project does not duplicate efforts by other agencies;

"(7) review agency budget requests for financial management, and advise the President, the Director, the Director of the Office of Federal Budget, and the Congress on the financial resources required to effectively operate and maintain the Government's financial management systems and to correct any major deficiencies in such systems;

"(8) review the development and enhancement of agency financial management systems in order to assure that the development and enhancement of such systems comply with approved agency financial management plans and are effectively carried out;

"(9) encourage and coordinate interagency projects to design and implement financial management systems that can be used by more than one agency in order to reduce the number of systems, eliminate duplication, and foster parity and consistency;

"(10) facilitate the exchange of information between agencies on financial management systems and efforts to improve such systems;

"(11) provide guidance to the Director of the Office of Personnel Management in the development and implementation of—

"(A) personnel qualifications and job descriptions for all executive agency financial management positions; and

"(B) professional development and training programs,

in order to ensure that qualified, trained personnel carry out Federal financial management functions; and

"(12) provide advice to agency heads with respect to the selection of agency controllers appointed under subchapter III of this chapter in order to help ensure the relevance of the background, experience, and capabilities of such controllers.

"(b)(1) Within one year after the date of enactment of this chapter, the Administrator shall prepare and transmit to the Congress, Director of the Office of Federal Management, and the Comptroller General a five-year plan for the financial management activities of the Federal Government. The plan shall provide for:

"(A) The strengthening of accounting, auditing, and financial reporting to ensure that complete, reliable, consistent, and timely financial information is available throughout the Government on a uniform basis and to ensure that such information meets the needs of agency management.

"(B) The development of reliable cost and performance information in order to enable the accurate and complete calculation of the costs of program results and alternatives based on accounting information from the financial management system and to enable the establishment of user fees for Government services based on the actual cost of providing such services.

"(C) The integration of accounting and budgeting systems in order to enable the use, in the budget formulation and execution processes, of accounting information and actual budget data for the most recently completed fiscal year which is obtained from the accounting systems.

"(D) The establishment of internal controls for financial management systems which are designed to ensure compliance with the objectives of subsections (b) and (c) of section 3512 of this title.

"(2) The Administrator of the Office of Financial Systems shall annually revise the plan required by paragraph (1) of this subsection and shall transmit the revised plan to the Congress, Director of the Office of Federal Management, and the Comptroller General.

"(3) Within 60 days after receiving a plan under paragraph (1) or (2) of this subsection, the Comptroller General shall prepare and transmit to the Congress a report which contains the analysis and comments of the Comptroller General with respect to the plan and the progress being made by agencies to strengthen financial management.

"§ 914. Regulations

"In the exercise of functions under this subchapter, the Administrator shall be subject to subsections (b), (c), and (d) of section 553 of title 5, notwithstanding subsection (a) of such section.

"SUBCHAPTER III—AGENCY CONTROLLERS

"§ 921. Appointment

"(a) There shall be in each agency specified in subsection (b) an agency controller, who shall be appointed by the head of the agency, after consultation with the Administrator of Financial Systems.

"(b) The agencies referred to in subsection (a) of this section are:

"(1) The Department of Agriculture.

"(2) The Department of Commerce.

"(3) The Department of Defense.

"(4) The Department of Education.

"(5) The Department of Energy.

"(6) The Department of Health and Human Services.

"(7) The Department of Housing and Urban Development.

"(8) The Department of the Interior.

"(9) The Department of Justice.

"(10) The Department of Labor.

"(11) The Department of State.

"(12) The Department of Transportation.

"(13) The Department of the Treasury.

"(14) The Department of the Army.

"(15) The Department of the Navy.

"(16) The Department of the Air Force.

"(17) The Environmental Protection Agency.

"(18) The General Services Administration.

"(19) The National Aeronautics and Space Administration.

"(20) The Small Business Administration.

"(21) The Veterans' Administration.

"§ 922. Functions

"An agency controller shall—

"(1) conduct, supervise, and coordinate all financial management activities and operations of the agency;

"(2) advise the agency head on financial management;

"(3) develop and maintain agency financial management systems, including accounting systems, internal control systems, and financial reporting systems, which—

"(A) implement the policies and procedures of the Administrator of Financial Systems and the accounting principles, standards, and requirements and internal control standards of the Comptroller General;

"(B) comply with the requirements of law applicable to such systems; and

"(C) provide for—

"(i) complete, reliable, consistent, and timely information which is prepared on a uniform basis and which is responsive to the financial information needs of agency management;

"(ii) the development of cost information;

"(iii) the integration of accounting and budgeting systems; and

"(iv) the systematic measurement of performance;

"(4) direct and manage agency financial management activities and operations, including—

"(A) the preparation and annual revision of a five-year agency financial management plan;

"(B) the development of agency financial management budgets;

"(C) the recruitment and training of qualified, trained personnel to carry out agency financial management functions;

"(D) the management of financial management system design or enhancement projects; and

"(E) the implementation of asset management systems, including systems for cash management, credit management, debt collection, and property and inventory management and control; and

"(5) prepare and transmit an annual report to the agency head and the Administrator of Financial Systems, which shall include—

"(A) a description and analysis of the status of agency financial management; and

"(B) copies of the most recently completed annual agency financial statements required under section 3515 of this title and the most recently completed biennial audit of such statements required under section 3516 of this title.".

(b)(1) Section 5313 of title 5, United States Code, is amended by adding at the end thereof the following new item:

"Director of the Office of Federal Management.".

(2) Section 5314 of such title is amended by adding at the end thereof the following new items:

"Deputy Director of the Office of Federal Management.

"Administrator of the Office of Financial Systems.".

(c)(1) Sections 503 and 504 of title 31, United States Code, are repealed.

(2) The chapter analysis for chapter 5 of such title is amended by striking out the items relating to sections 503 and 504.

DEFINITIONS

SEC. 103. For purposes of this title—

(1) the term "Administrator" means the Administrator of the Office of Financial Systems appointed under section 912 of title 31, United States Code (as added by section 102(a) of this Act); and

(2) the term "Director" means the Director of the Office of Federal Management appointed under section 902(a) of title 31, United States Code (as added by section 102(a) of this Act).

TRANSFERS

SEC. 104. (a)(1) The Office of Information and Regulatory Affairs is transferred to the Office of Federal Management.

(2) There are transferred to the Director of the Office of Federal Management all functions of the Director of the Office of Management and Budget with respect to, or being administered through, the Office of Information and Regulatory Affairs.

(b)(1) The Office of Federal Procurement Policy is transferred to the Office of Federal Management.

(2) There are transferred to the Director of the Office of Federal Management all functions of the Director of the Office of Management and Budget with respect to, or being administered through, the Office of Federal Procurement Policy.

(c) There are transferred to the President—

(1) all functions specified in sections 903 and 913 of title 31, United States Code (as added by section 102 of this Act) which, on the day before the date of enactment of this Act, were vested by law in the Director of the Office of Management and Budget; and

(2) all functions specified in such sections 903 and 913 which were, on the day before the date of enactment of this Act, carried out by the President through, or delegated by the President to, the Director of the Office of Management and Budget.

(d) The President shall delegate to the Director of the Office of Federal Management all functions transferred to the

President under subsection (c), except that the delegation of such functions under this subsection shall not relieve the President of responsibility for the administration of such functions.

(e) The Director shall delegate to the Administrator all of the functions which are specified in section 913 of title 31, United States Code (as added by section 102 of this Act) and which are delegated to the Administrator under subsection (d), except that the delegation of such functions under this subsection shall not relieve the Director of responsibility for the administration of such functions.

REFERENCE

SEC. 105. With respect to the functions transferred by this title to the Director or the Administrator and exercised after the effective date of this title, reference in any other Federal law to—

(1) the Director of the Office of Management and Budget; or

(2) the Office of Management and Budget or any officer or office thereof,

shall be considered to refer to the Director or the Administrator, as the case may be.

TRANSITION

SEC. 106. With the consent of the President, the Director is authorized to utilize—

(1) the services of such officers, employees, and other personnel of the Office of Management and Budget with respect to functions or offices transferred to the Director or the Office of Federal Management by this title; and

(2) funds appropriated to such functions or offices for such period of time as may reasonably be needed to facilitate the orderly implementation of this title.

PERSONNEL PROVISIONS

SEC. 107. (a) Except as otherwise provided in this title, the personnel employed in connection with, and the assets, liabilities, contracts, property, records, and unexpended balances of appropriations, authorizations, allocations, and other funds employed, used, held, arising from, available to, or to be made available in connection with the functions and offices transferred by this title, subject to section 1531 of title 31, United States Code, shall be transferred to the President. Unexpended funds transferred pursuant to this section shall be used only for the purposes for which the funds were originally authorized and appropriated.

(b)(1) The President, at such time or times as the President shall provide, is authorized to make such determinations as may be necessary with regard to the functions and offices transferred by this title, and to make such additional incidental dispositions of personnel, assets, liabilities, grants, contracts, property, records, and unexpended balances of appropriations, authorizations, allocations, and other funds held, used, arising from, available to, or to be made available in connection with such functions and offices, as may be necessary to carry out the provisions of this title. The President shall provide for such measures and dispositions as may be necessary to effectuate the purposes of this title.

(2) After consultation with the Director of the Office of Personnel Management, the President is authorized, at such times as the President may provide, to make such determinations as may be necessary with regard to the transfer of positions within the Senior Executive Service in connection with the functions and offices transferred by this title.

(c)(1) Except as otherwise provided by this title, the transfer pursuant to this title of full-time personnel (except special Government employees) and part-time personnel holding permanent positions shall not cause any such employee to be separated or reduced in grade or compensation for one year after the date of transfer of such employee under this title.

(2) Any person who, on the day preceding the effective date of this title, held a position compensated in accordance with the Executive Schedule prescribed in chapter 53 of title 5, United States Code, and who, without a break in service, is appointed in a Federal agency to which functions are transferred by this title to a position having duties compara-

ble to the duties performed immediately preceding such appointment shall continue to be compensated in such new position at not less than the rate provided for such previous position, for the duration of the service of such person in such new position.

SAVINGS PROVISIONS

SEC. 108. (a) All orders, determinations, rules, regulations, permits, contracts, certificates, licenses, and privileges that—

(1) have been issued, made, granted, or allowed to become effective by the President, any Federal agency or official thereof, or by a court of competent jurisdiction, in the performance of functions which are transferred by this title; and

(2) are in effect when this title takes effect,

shall continue in effect according to their terms until modified, terminated, superseded, set aside, or revoked in accordance with law by the President, the Director, a court of competent jurisdiction, or by operation of law.

(b)(1) The provisions of this title shall not affect any proceedings, including notices of proposed rule making, or any application for any license, permit, certificate, or financial assistance pending on the effective date of this title before the Office of Management and Budget or any office thereof with respect to functions transferred by this title; but such proceedings or applications, to the extent that they relate to functions transferred, shall be continued. Orders shall be issued in such proceedings, appeals shall be taken therefrom, and payments shall be made under such orders, as if this Act had not been enacted; and orders issued in any such proceedings shall continue in effect until modified, terminated, superseded, or revoked by the Director, by a court of competent jurisdiction, or by operation of law. Nothing in this subsection prohibits the discontinuance or modification of any such proceeding under the same terms and conditions and to the same extent that such proceeding could have been discontinued or modified if this Act had not been enacted.

(2) The Director and the Director of the Office of Management and Budget are authorized to issue regulations providing for the orderly transfer of proceedings continued under paragraph (1).

(c) Except as provided in subsection (e)—

(1) the provisions of this title do not affect actions commenced prior to the effective date of this title, and

(2) in all such actions, proceedings shall be had, appeals taken, and judgments rendered in the same manner and effect as if this Act had not been enacted.

(d) No action or other proceeding commenced by or against any officer in his official capacity as an officer of the Office of Management and Budget with respect to functions transferred by this title shall abate by reason of the enactment of this title. No cause of action by or against the Office of Management and Budget with respect to functions transferred by this title, or by or against any officer thereof in his official capacity, shall abate by reason of the enactment of this Act. Causes of action and actions with respect to a function or office transferred by this title, or other proceedings may be asserted by or against the United States or an official of the Office of Federal Management, as may be appropriate, and, in an action pending when this title takes effect, the court may at any time, on its own motion or that of any party, enter an order which will give effect to the provisions of this subsection.

(e) If, before the date on which this title takes effect, the Office of Management and Budget or any officer thereof in his official capacity, is a party to an action, and under this title any function of such Office or officer is transferred to the Director, then such action shall be continued with the Director substituted or added as a party.

(f) Orders and actions of the Director in the exercise of functions transferred to the Director by this title shall be subject to judicial review to the same extent and in the same manner as if such orders and actions had been by the Director of the Office of Management and Budget or any office or officer thereof, in the exercise of such functions immediately preceding their transfer. Any statutory requirements relating to notice, hearings, action upon the record, or administrative review that apply to any function transferred by this title shall apply to the exercise of such function by the Director.

REDESIGNATION

SEC. 109. (a)(1) The Office of Management and Budget is hereby redesignated as the Office of Federal Budget and the Director of the Office of Management and Budget or any other official of the Office of Management and Budget is hereby redesignated the Director or official, as appropriate, of the Office of Federal Budget.

(2) Any reference to the Office of Management and Budget, the Director of the Office of Management and Budget, or any other official of the Office of Management and Budget in any law, rule, regulation, certificate, directive, instruction, or other official paper in force on the effective date of this title shall be deemed to refer and apply to the Office of Federal Budget or the Director of the Office of Federal Budget, respectively, except to the extent such reference is to a function transferred to the Director or the Administrator under this title.

(b)(1) Section 501 of title 31, United States Code, is amended by striking out "Management and" each place it appears in the text and the section heading and inserting in lieu thereof "Federal".

(2) Section 502 of such title is amended by striking out "Management and" each place it appears and inserting in lieu thereof "Federal".

(3) The chapter analysis for chapter 5 of such title is amended by striking out "Management and" in the chapter heading and in the item relating to section 501 and inserting in lieu thereof "Federal".

(4) The item relating to chapter 5 in the analysis for subtitle I of such title is amended by striking out "Management and" and inserting in lieu thereof "Federal".

EFFECTIVE DATE

SEC. 110. (a) This title shall take effect one hundred and twenty days after the date of enactment of this Act, except that—

(1) section 111 shall take effect on the date of enactment; and

(2) at any time after the date of enactment of this Act—

(A) the officers provided for in chapter 9 of title 31, United States Code (as added by section 102 of this Act) may be nominated and appointed, as provided in such chapter; and

(B) the Director and the Director of the Office of Management and Budget may promulgate regulations under section 108(b)(2).

(b) Funds available to the Office of Management and Budget (or any official or component thereof), with respect to the functions and offices transferred by this title, may be used, with approval of the President, to pay the compensation and expenses of an officer appointed under subsection (a)(2)(A) who will carry out such functions until funds for that purpose are otherwise available.

INTERIM APPOINTMENTS

SEC. 111. (a) If one or more officers required by chapter 9 of title 31, United States Code (as added by section 102 of this Act) to be appointed by and with the advice and consent of the Senate have not entered upon office on the effective date of this title and notwithstanding any other provision of law, the President may designate any officer who was appointed by and with the advice and consent of the Senate, and who was such an officer on the day before the effective date of this title, to act in the office until it is filled as provided by such chapter.

(b) Any officer acting in an office pursuant to subsection (a) shall receive compensation at the rate prescribed by chapter 53 of title 5, United State Code, for such office.

AUTHORIZATION OF APPROPRIATIONS

SEC. 112. There are authorized to be appropriated such sums as may be necessary to carry out the provisions of this title. Amounts appropriated under this section shall be available until expended.

PART B—ANNUAL MANAGEMENT REPORT

PRESIDENTIAL REPORT

SEC. 121. (a) Chapter 11 of title 31, United States Code, is amended by adding at the end thereof the following new section:

"§ 1115. Annual management report

"(a) With each budget of the United States Government submitted under section 1105 of this title, the President shall submit to the Congress a report on the management of the executive branch of the Government with respect to the most recently completed fiscal year, the current fiscal year, and the fiscal year for which the budget is submitted. Each such report shall include—

"(1) an overview of the general management improvement goals of the President for the executive branch of the Government during such fiscal years;

"(2) a summary of the management problems and issues for the executive branch of the Government, and the major management improvement initiatives and accomplishments for the executive branch of the Government, involving—

"(A) program delivery systems;

"(B) human resources management;

"(C) productivity;

"(D) information resources management;

"(E) financial management;

"(F) procurement and grants management;

"(G) property management; and

"(H) any other relevant subject areas; and

"(3) for each initiative summarized in paragraph (2), a description, where feasible and appropriate, of—

"(A) the purpose of the initiative;

"(B) the progress and problems in the implementation of the initiative; and

"(C) the impact of the initiative on agency operations, including—

"(i) any additional costs which have been incurred as a result of the implementation of the initiative;

"(ii) any cost savings which have been achieved or which are projected as a result of the implementation of the initiative;

"(iii) any improvements in Federal program efficiency or productivity which have resulted from the implementation of the initiative; and

"(iv) any improvements in the delivery of services which have resulted from the implementation of the initiative;

"(4) proposals for legislative or other action to improve the management or organization of the executive branch of the Government, including proposals to remove statutory impediments to the improvement of the management of the executive branch of the Government; and

"(5) a summary of each significant new management policy for the executive branch of the government which has been adopted or which is planned for the current fiscal year or the fiscal year for which the budget is submitted, and a discussion of the reasons for such policy.".

(b) The analysis for chapter 11 of such title is amended by adding at the end thereof the following:

"1115. Annual management report.".

REVIEW OF REPORT BY COMPTROLLER GENERAL

SEC. 122. Section 719 of title 31, United States Code, is amended—

(1) by redesignating subsections (g) through (i) as subsections (h) through (j), respectively; and

(2) by inserting after subsection (f) the following new subsection:

"(g) Within 90 days after the President has submitted a report under section 1115 of this title, the Comptroller General shall prepare and transmit to the Congress a statement analyzing such report. The statement shall include—

"(1) an evaluation of the items contained in such report which the Comptroller General considers to be of particular interest to the Congress;

"(2) a specification of any questions or issues raised by such report which the Comptroller General considers to require further clarification;

"(3) an analysis of the extent to which such report complies with the requirements of section 1115 of this chapter; and

"(4) recommendations, if any, for improvement of the management or organization of the executive branch of the Government, including modification or repeal of statutory impediments to efficient and effective management.".

TITLE II—ACCOUNTING AND INTERNAL CONTROL SYSTEMS

FINDING AND PURPOSE

SEC. 201. The Congress finds that executive agencies must have reliable and effective accounting and internal control systems. Therefore, it is the purpose of this title to ensure that, within two years after the date of enactment of this Act, the financial systems of executive agencies will conform to the accounting principles, standards, and requirements, and with the internal control standards, prescribed by the Comptroller General pursuant to law.

FEDERAL BUDGET REQUIREMENTS

SEC. 202. Section 1105 of title 31, United States Code, is amended—

(1) by redesignating subsections (c), (d), and (e) as subsections (d), (e), and (f), respectively; and

(2) by inserting after subsection (a) the following new subsection:

"(b)(1) The President shall include in the budget a statement as to whether, and to what extent, the information submitted under subsection (a) was generated or supported by an accounting system that conforms to the accounting principles, standards, and requirements prescribed by the Comptroller General, and to such accounting and other related requirements as may be required by the Administrator of the Office of Financial Systems. To the extent an accounting system does not conform to such principles, standards, and requirements, the President shall include in such statement an analysis and explanation of the problems with the system and the steps taken to assure that the Congress can rely on the accuracy of the information presented in the budget submitted under subsection (a) of this section.

"(2) The statement required by paragraph (1) shall include a separate specification of the matters described in such paragraph for each executive department, agency, and office which maintains an accounting system used in preparing or supporting budget requests.".

ACCOUNTING SYSTEMS

SEC. 203. Section 3512 of title 31, United States Code, is amended by adding at the end thereof the following new subsection:

"(g) The Administrator of the Office of Financial Systems shall review reports submitted under this section by the head of each executive agency. Based on such reviews, reports by the General Accounting Office, and such additional information as may be appropriate, the Administrator shall determine whether the accounting and internal controls systems substantially comply with the requirements of this section. If, after two years after the effective date of this subsection, the Administrator determines that an accounting or internal control system does not substantially comply with the requirements of this section, the accounting and other financial management operations of the agency which are supported by the system will be subject to the direction and supervision of the Administrator to the extent considered necessary by the Administrator.".

TITLE III—AGENCY FINANCIAL STATEMENTS

FINDING AND PURPOSE

SEC. 301. The Congress finds that the effective and efficient management of Government resources, and the making of informed policy and programmatic decisions, can better be achieved if the Congress and executive agencies have complete, accurate, and timely information on the financial position and the results of operation of the Government. Therefore, it is the purpose of this title to ensure that such information is available by requiring the annual preparation and biennial audit of agency financial statements, and an annual audit of the financial statements of Government corporations.

ACCOUNTING REQUIREMENTS

SEC. 302. (a) Subsection (a) of section 3511 of title 31, United States Code, is amended by inserting a comma and "the Administrator of the Office of Financial Systems," after "Treasury".

(b) Paragraph (3)(B) of section 3511(b) of such title is amended by inserting ", including a method for the preparation of financial statements" before the semicolon.

PREPARATION AND AUDIT OF STATEMENTS

SEC. 303. (a) Subchapter II of chapter 35 of title 31, United States Code, is amended by adding at the end thereof the following new sections:

"§ 3515. Preparation of agency financial statements

"(a) By December 31 each year (beginning with the year in which ends the first full fiscal year completed after the date of enactment of this section) each executive agency shall have prepared financial statements that include the accounts of all of its offices, bureaus, and activities and that present the financial position and results of operations of such agency during the preceding fiscal year.

"(b) The Administrator of the Office of Financial Systems, in conjunction with the Secretary of the Treasury and in consultation with the Comptroller General, shall prescribe the form and content of the financial statements required by subsection (a). Such form and content shall be consistent with the principles, standards, and requirements prescribed by the Comptroller General under section 3511 of this title.

"§ 3516. Audit of agency financial statements

"(a) Beginning with the financial statements prepared under section 3515(a) of this title for fiscal years 1990 and 1991, and biennially thereafter, a financial and compliance audit shall be performed of the financial statements prepared under such section for the two most recently completed fiscal years. The audit shall be conducted in accordance with generally accepted Government auditing standards issued by the Comptroller General.

"(b) A financial and compliance audit of an executive agency's financial statements required by subsection (a) of this section shall be performed by—

"(1) the Inspector General of the executive agency;

"(2) an internal auditor of the executive agency who is independent (as defined by generally accepted

Government auditing standards issued by the Comptroller General); or

"(3) an independent external auditor who meets the qualifications and other requirements of the generally accepted Government auditing standards issued by the Comptroller General.

"(c) The Comptroller General shall perform the audit required by subsection (a) of this section, when deemed appropriate by the Comptroller General or upon the request of a committee of Congress. An audit performed by the Comptroller General under this subsection shall be in lieu of the audit that otherwise would be performed by the persons specified in subsection (b) of this section.

"(d) The Comptroller General is authorized to review an audit conducted by the Inspector General of an executive agency, an internal auditor of an executive agency, or an independent external auditor, to ensure compliance with the accounting and audit requirements of this section. The Comptroller General shall report to the Congress and the executive agency the results of any review conducted under this paragraph, and shall include in such report any recommendations the Comptroller General considers appropriate.

"(e) For any audit conducted under this section, a report on the audit shall be transmitted to the head of the executive agency and the Congress by April 30 following the end of the fiscal year for which such audit was conducted. A copy of the report shall be transmitted to the President, the Administrator of the Office of Financial Systems, and the Comptroller General.

"(f) Within two years after the date of enactment of this section, the Administrator, in consultation with the Comptroller General, agency controllers, and the Inspectors General, shall submit to the Congress a plan for ensuring that the audits required by this section for agency financial statements for fiscal year 1991 are completed. The Administrator shall subsequently notify the Congress of any substantive changes to the plan submitted.".

(b) The chapter analysis for such chapter is amended by inserting after the item relating to section 3514 the following new items:

"3515. Preparation of agency financial statements.
"3516. Audit of agency financial statements.".

AUDITS OF GOVERNMENT CORPORATIONS

SEC. 304. Section 9105 of title 31, United States Code, is amended to read as follows:

"§ 9105. Audits

"(a)(1) The financial statements of—

"(A) wholly owned Government corporations; and

"(B) mixed-ownership Government corporations during periods in which capital of the United States

Government is invested in a mixed-ownership Government corporation,

shall be audited annually by an independent external auditor in accordance with generally accepted Government auditing standards issued by the Comptroller General. The Government corporation's financial statements shall be presented in accordance with generally accepted accounting principles.

"(2) The Comptroller General is authorized to review an audit conducted by a Government corporation's independent external auditor to ensure compliance with the accounting and auditing requirements specified by this section. The Comptroller General shall report to the Congress and the Government corporation the results of any review conducted under this paragraph, and shall include in such report any recommendations the Comptroller General considers appropriate.

"(b)(1) In lieu of an annual audit that otherwise would be performed by an independent external auditor under paragraph (1) of subsection (a), the Comptroller General, as the Comptroller General considers necessary or upon the request of a committee of Congress, shall audit the financial statements of a Government corporation in the manner provided in such paragraph.

"(2) A Government corporation shall reimburse the Comptroller General for the full cost of any audit conducted under paragraph (1) of this subsection, as determined by the Comptroller General. Reimbursements received by the Comptroller General shall be retained and used for authorized purposes.

"(c) All books, accounts, financial records, reports, files, workpapers, and property belonging to or in use by a Government corporation and the Government corporation's auditor, needed for purposes of this section, shall be made available to the representatives of the Comptroller General.

"(d) Activities conducted under subsection (a)(2) or (b)(1) are in lieu of an audit of the financial transactions of a Government corporation the Comptroller General is required to make in reporting to Congress or the President under any other law.

"(e) Necessary amounts are authorized to be appropriated to the Comptroller General to carry out this section.".

FINANCIAL REPORTS OF GOVERNMENT CORPORATIONS

SEC. 305. Section 9106 of title 31, United States Code, is amended to read as follows:

"§ 9106. Financial reports

"(a)(1) A Government corporation shall submit to Congress a report of financial position and results of operations, including an audit conducted under section 9105(a)(1) of this title, not later than April 30 after the end of the Government corporation's fiscal year. The corporation's financial statements shall be in accordance with generally accepted accounting principles and shall include—

"(A) a balance sheet showing assets, liabilities, capital and surplus or deficit;

"(B) a statement of income; and

"(C) a statement of changes in financial position.

"(2) A Government corporation's financial report shall also include—

"(A) an opinion on the financial statements resulting from an audit conducted under section 9105 of this title; and

"(B) any other comments and information necessary to inform Congress about the operations and financial condition of the corporation.

"(b) A Government corporation shall give the President, the Administrator of the Office of Financial Systems, the Secretary of the Treasury, and the Comptroller General a copy of the report when it is submitted to Congress.".

TITLE IV—CASH MANAGEMENT

PURPOSE

SEC. 401. It is the purpose of this title to increase the efficiency of efforts to manage cash throughout the Government by providing additional procedures and incentives for cash management.

DISBURSEMENT OBJECTIVES

SEC. 402. (a) Subchapter II of chapter 37 of title 31, United States Code, is amended by adding at the end thereof the following new section:

"§ 3720B. Disbursement of Federal funds

"(a) Each head of an agency (other than an agency subject to section 9 of the Act of May 18, 1933 (48 Stat. 63, chapter 32, 16 U.S.C. 831h) shall, under such regulations as the Secretary of the Treasury, in consultation with the Administrator of the Office of Financial Systems, prescribe, provide for the timely disbursement of Federal funds through cash, checks, electronic funds transfer, or any other means identified by the Secretary. The Secretary is authorized to collect from any agency not complying with the requirements imposed pursuant to the preceding sentence a charge in an amount the Secretary determines to be the cost to the general fund caused by such noncompliance.

"(b) The head of an executive agency shall pay to the Secretary of the Treasury charges imposed pursuant to subsection (a). Payments shall be made out of amounts appropriated or otherwise made available to carry out the program to which the disbursements relate. The amounts of the charges paid under this subsection shall be deposited in the Cash Management Improvements Fund established under section 3720(c) of this title.".

(b) The chapter analysis for chapter 37 of such title is amended by inserting after the item relating to section 3720A the following new item:

"3720B. Disbursement of Federal funds.".

(c) The Secretary of the Treasury, in consultation with the Administrator of the Office of Financial Systems, shall prescribe regulations, including the regulations required under subsection (a) of section 3720B of title 31, United States Code (as added by subsection (a) of this section) to ensure the full implementation of such section 3720B by October 1, 1987.

PAYMENT OF INTEREST

SEC. 403. (a) Section 6501 of title 31, United States Code, is amended—

(1) by redesignating clauses (7), (8), and (9) as clauses (9), (10), and (11), respectively;

(2) by inserting after clause (6) the following new clauses:

"(7) 'Administrator' means the Administrator of the Office of Financial Systems.

"(8) 'Secretary' means the Secretary of the Treasury."; and

(3) by striking out clause (10) (as redesignated by clause (1) of this subsection) and inserting in lieu thereof the following:

"(10) 'State' means a State of the United States, the District of Columbia, a territory or possession of the United States, and an agency, instrumentality, or fiscal agent of a State but does not mean a local government of a State.".

(b)(1) Section 6503 of title 31, United States Code, is amended to read as follows:

"§ 6503. Intergovernmental financing

"(a) Consistent with program purposes, and regulations of the Secretary, and by means mutually agreed upon by the Secretary and the State, the head of an executive agency carrying out a program shall schedule the transfer of funds to minimize the time elapsing between transfer of funds from the United States Treasury and the issuance or redemption of checks, warrants, or payments by other means by a State.

"(b) Consistent with program purposes and regulations of the Secretary and by means mutually agreed upon by the Secretary and the State, a State shall minimize the time elapsing between transfer of funds from the United States Treasury and the issuance or redemption of checks, warrants, or payments by other means for program purposes.

"(c) The Secretary is authorized to issue regulations that would require a State to pay interest on funds from the time they are deposited to the State's account until the time that they are paid out in order to redeem checks or warrants, or make payments by other means for program purposes. Such interest shall be at the rate specified from time to time by the Secretary pursuant to section 323 of this title, relating to Treasury tax and loan accounts.

"(d) If a State disburses its own funds for program purposes in accordance with Federal law, regulation, or Federal-State agreement, the State shall be entitled to interest at the rate specified pursuant to section 323 of this title, from the time the State's funds are paid out to redeem checks or warrants, or make payments by other means until the Federal funds are deposited to the State's bank account. Such interest shall be paid out of the Intergovernmental Interest Fund established by section 6509(a) of this title.

"(e) If a State collects and holds refunds of grant funds, such refunds shall be distributed to the Federal Government on a timely basis or used to offset related Federal program funds owed to the State. Interest earned on such refunds shall be considered when setting overall interest obligations between the State and the Federal Government as required by this section.

"(f) In cases where the Federal Government makes payment on behalf of a recipient organization, the principles of this section shall apply.

"(g) A State may not be required by a law or regulation of the United States to deposit grant money received by it in a separate bank account. However, a State shall account for grant money made available to the State as United States Government grant money in the accounts of the State. The head of the State agency concerned shall make periodic authenticated reports to the head of the appropriate Federal executive agency on the status and the application of the money, the liabilities and obligations on hand, and other information required by the head of the executive agency. Records related to the grant received by the State shall be made available to the head of the executive agency and the Comptroller General for auditing, as prescribed by Chapter 15 of this title.

"(h) The Secretary shall prescribe the methods of payment of interest between the Federal Government and the States, including provisions for offsetting amounts owed by the respective parties. These methods of payment shall provide for comparable treatment in the manner, technique and timing for both the States and the Federal Government.

"(i) The Inspector General of an agency, or an officer of any agency performing functions similar to an Inspector General, in the case of an agency in which an Inspector General has not been established by law, shall periodically conduct audits. Periodic audits shall also be conducted by the States within the scope of work performed under chapter 15 of this title.

"(j) Consistent with Federal program purposes and regulations of the Administrator of the Office of Financial Systems, the head of a Federal executive agency carrying out a program shall execute grant awards on a timely basis to assure the availability of funds to accomplish transfers in compliance with subsection (a) of this section.

"(k) In assessing charges to be paid by a State to the Federal Government under subsection (c), or to a State by the Federal Government under subsection (d), the Secretary shall consider costs incurred by the State in administering this section.".

(2) The item relating to section 6503 in the chapter analysis for chapter 65 of title 31, United States Code, is amended to read as follows:

"6503. Intergovernmental financing.".

(c)(1) Chapter 65 of title 31, United States Code, is amended by adding at the end thereof the following new section:

"§ 6509. Intergovernmental interest fund

"(a) There is established in the Treasury of the United States a fund known as the Intergovernmental Interest Fund (hereafter in this section referred to as the 'Fund').

"(b) The Fund shall include amounts received as payment of interest under section 6503(c) of this title, and such sums as may be necessary to pay interest pursuant to section 6503(d) of this title.

"(c) Moneys in the Fund shall be available without fiscal year limitation.

"(d) The Secretary is authorized to credit such portions of the Fund as the Secretary determines are in excess of the amount necessary to pay claims to miscellaneous receipts in the Treasury.

"(e) Where interest is earned by a State on a program where only the Secretary of the Treasury is authorized to invest funds, the interest earned shall be credited to the appropriate trust fund.".

(2) The chapter analysis for such chapter is amended by adding at the end thereof the following new item:

"6509. Intergovernmental Interest Fund.".

(d) The provisions of this section and the amendments made by this section shall apply to all Federal programs and shall supersede the provisions of any Federal law or regulation in effect on the date of enactment of this Act.

(e) The amendments made by this section shall take effect on the date of enactment of this Act, except that the provisions of section 6503 of title 31, United States Code (as added by subsection (b) of this section) which relate to the payment and receipt of interest by the Federal Government and State governments shall take effect two years after the date of enactment of this Act.

SOCIAL SECURITY WITHHOLDING

SEC. 404. Section 218(e)(1)(A) of the Social Security Act is amended to read as follows:

"(A) that the State will pay to the Secretary of the Treasury, in accordance with the same payment schedule as applies to payment by employers of the taxes imposed under sections 3101 and 3111 of the Internal Revenue Code of 1954, amounts equivalent to the sum of the taxes which would be imposed by sections 3101 and 3111 of such Code if the services for which wages were paid in such month to employees covered by the agreement constituted employment as defined in section 3121 of such Code; and".

ELECTRONIC FUNDS TRANSFER

SEC. 405. (a) Section 3332 of title 31, United States Code, is amended by striking out subsections (a), (b), (c), (d), and (e), and inserting in lieu thereof the following:

"(a) In this section, 'financial organization' means a bank, savings and loan association, a credit union chartered by the United States Government or a State, or a similar institution.

"(b)(1) Notwithstanding any other provision of law, the Secretary of the Treasury, in consultation with the Administrator of the Office of Financial Systems, may issue regulations requiring, where the Secretary determines it to be cost effective, that wages and salaries of any or all employees of an agency be paid by electronic funds transfer or any other method determined by the Secretary to be in the interest of economy and effectiveness, with sufficient safeguards over the control of, and accounting for, public funds.

"(2) Such regulations shall require covered employees to designate the financial organization to receive payments of their salaries and wages.

"(3) Such regulations may allow for payments of salary and wages by check to be mailed on the due date.

"(4) The head of each employing agency shall include in certifications of payments of wages and salaries information required by the Secretary about the financial organization chosen by the agency's employees.

"(5) The Secretary shall not charge financial organizations any fees in connection with payments made in accordance with this section.

"(6) Financial organizations shall not charge agency employees for handling payments made in accordance with this section.

"(7) The Secretary may, upon request by an employee who was employed by the United States Government on the effective date of this section and whose annual rate of basic pay is less than $20,000, exempt such employee from the requirements of this section.

"(c) Payment of an amount by the United States by methods authorized pursuant to subsection (b) or (d) of this section, and accepted by a financial organization, shall constitute full acquittance of the United States for that amount.

"(d) Notwithstanding any other provision of law, the Secretary, in consultation with the Administrator, may develop regulations which would allow conversion of a regular payment from one method to another without the employee's written request using any method authorized by the Secretary pursuant to this section, if the following conditions are met:

"(1) The employee is notified by the Secretary or the designee of the Secretary of the proposed change along with the new payment information in writing.

"(2) The employee has thirty days in which to notify the Secretary or his designee that information specified pursuant to clause (1) should be changed.

"(e)(1) Notwithstanding any other provision of law, the Secretary, in consultation with the Administrator, may issue regulations requiring that, where the Secretary determines to be practicable, benefit and other payments may be made by electronic funds transfer or any other method determined by the Secretary to be in the interest of economy and effectiveness, with sufficient safeguards over the control of, and accounting for, public funds as long as the recipient has the option of receiving a check.

"(2) The requirements of paragraphs (5) and (6) of subsection (b) and of subsections (c) and (d) of this section shall apply to benefits and other payments made under paragraph (1) of this subsection.".

(b) Section 3332(f) of such title is amended by striking out "The" in the first sentence and inserting in lieu thereof "Notwithstanding subsection (b)(1) of this section, the".

(c) The amendments made by this section shall take effect on October 1, 1986.

IMPROVING THE COLLECTION AND DEPOSIT OF GOVERNMENT RECEIPTS THROUGH NATIONAL LOCKBOX SYSTEMS

SEC. 406. (a) For purposes of this section—

(1) the term "Administrator" means the Administrator of the Office of Financial Systems;

(2) the term "executive agency" has the same meaning as in section 102 of title 31, United States Code;

(3) the term "lockbox system" means a system under which—

(A) persons owing payments to an executive agency transmit such payments to a locked post office box in offices of the United States Postal Service; and

(B) such payments are collected from such box by a financial institution and are credited by such institution to the account of such agency without any specific action by such agency; and

(4) the term "Secretary" means the Secretary of the Treasury.

(b) The Secretary shall study and make recommendations concerning standards for the establishment of lockbox systems for executive agencies. In conducting such study, the Treasury shall—

(1) consider—

(A) the feasibility of establishing such systems;

(B) the benefits and costs of establishing such systems; and

(C) the needs of each executive agency for such a system;

(2) develop methods of internal controls and accounting by which the Government can assure that payments received through a lockbox system will be promptly and fully credited to the Treasury of the United States;

(3) develop criteria for the adoption of lockbox systems by executive agencies;

(4) analyze the feasibility and costs of operating lockbox systems through the Department of the Treasury, the Federal Reserve Board, or other appropriate executive agencies; and

(5) develop recommendations for the establishment of lockbox systems by executive agencies, with the cost of establishing and operating such systems paid by appropriated funds; and

(c) Executive agencies using lockbox services developed under this section shall pay the Secretary the actual cost for such services from their appropriated funds. Such payments shall be deposited in the Treasury as miscellaneous receipts. The Secretary shall use its appropriated funds to pay operators of the lockboxes used under this section.

(d) Within one hundred and eighty days after the date of enactment of this Act, the Secretary shall submit a report on the study conducted under subsection (b) to the President pro tempore of the Senate, the Speaker of the House of Representatives, and the Administrator. The report shall describe the findings of the study and contain such recommendations as the Secretary considers appropriate.

(e) Within ninety days after receiving the report required under subsection (d), and after consulting with the Administrator, the Secretary shall prescribe guidelines which specify procedures to be used by executive agencies in determining whether to establish and operate lockbox systems.

(f) Within ninety days after the Secretary prescribes guidelines under subsection (f), the head of each executive agency shall submit to the Secretary a report describing the plans of such agency for the establishment of a lockbox system or specifying the reasons why such a system is not feasible or cost effective for such agency.

TITLE V—CREDIT MANAGEMENT

PURPOSE

SEC. 501. It is the purpose of this title to strengthen the overall management of Federal credit programs and to make these programs consistent with the goals of deficit reduction by—

(1) assuring the proper management of credit transactions of Federal agencies;

(2) increasing the efficiency of Governmentwide efforts to collect debts owed the United States; and

(3) providing additional procedures for the management and collection of debts owed to the United States.

IMPROVEMENT OF CREDIT MANAGEMENT PROGRAMS

SEC. 502. Title 31, United States Code, is amended by inserting after chapter 37 the following new chapter:

“CHAPTER 38—CREDIT MANAGEMENT

“SUBCHAPTER I—GENERAL PROVISIONS

“Sec.
“3801. Definitions.

“SUBCHAPTER II—CREDIT EXTENSION AND ADMINISTRATION

“3811. Subsidy statement.
“3812. Interest rates.
“3813. Loan origination and application fees.
“3814. Prior default by applicant.
“3815. Default and acceleration clauses.
“3816. Private sector participation.
“3817. Regulations and financial contract.
“3818. Effective date.

“SUBCHAPTER III—DEBT MANAGEMENT

“3821. Collection targets.
“3822. Delinquency and default standards.
“3823. Audit of credit programs.
“3824. Regulation deadline.

“SUBCHAPTER I—GENERAL PROVISIONS

“§ 3801. Definitions

“For purposes of this chapter—

“(1) The term ‘Federal agency’ means an executive department, an independent Federal establishment, or a corporation or other entity established by law that is owned in whole or in part by the United States.

“(2) The term ‘obligation’ means any note, bond, debenture, or other evidence of indebtedness, but does not include Federal Reserve notes or stock evidencing an ownership interest in the issuing Federal agency.

“(3) The term ‘direct loan’ means a disbursement of funds by a Federal agency (not in exchange for goods or services) under a contract that requires the repayment of such funds with or without interest. Such term shall also include an obligation guaranteed by a Federal agency and purchased by the Federal Financing Bank. Such term shall not include any commodity price-support loan made by the Commodity Credit Corporation.

"(4) The term 'subsidy' means, with respect to a direct loan, the difference between—

"(A) the costs (including interest) which would have been incurred by a borrower to obtain the loan from private sources, minus

"(B) the costs (including interest) which were incurred by the borrower to obtain the loan from the Government.

"(5) The term 'debt' means an amount of money or property that has been determined by an appropriate official of an agency to be owed to the United States by any person, organization, or entity except another Federal agency.

"(6) The term 'loan guarantee' means contingent liability of an agency. A guaranteed loan is—

"(A) any debt obligation on which the agency pledges to pay part or all of the amount due to a lender or holder in the event of default by the borrower; or

"(B) a direct Federal loan that an agency sold under a guarantee or agreement to repurchase.

"(7) The term 'credit extension' means that portion of the credit management cycle involving review and approval of requests for short-term or long-term credit.

"(8) The term 'financial contract' means any agreement or contract made by an agency, the primary purpose or results of which is to make private credit available, or available on more favorable terms than in the absence of the contract, to a non-Federal entity by indirectly or directly assuming the risk involved. Such term includes financial contracts such as an agreement to pay all or part of the principal or interest on the debt obligation of a non-Federal entity (debt service payments), financial lease agreements for assets and project financing, and repayment arrangements.

"(9) The term 'creditworthy' means a favorable determination entitling an applicant to receive credit, which is based on—

"(A) the perceived ability and willingness of the borrower to repay the debt and the lending organization's level of acceptable risk; and

"(B) the consideration of other Federal obligations that could jeopardize or be jeopardized by the new debt under consideration.

"(10) The term 'receivables' means amounts owed the Government upon completion of the acts giving rise to claims, and includes amounts, such as amounts due for taxes, loans, sales of goods and services, fines, penalties, forfeitures, interest, overpayments, fees, duties, rents, royalties, claims, damages, audit disallowances, and travel advances.

"(11) The term 'account servicing' means that portion of the credit management cycle dealing with monitoring the status of accounts of indebtedness, maintaining records of current debts, billing for amounts due, collecting amounts due, dunning for past due amounts, handling debtor correspondence, performing followup functions, and providing accurate reporting of debt portfolios.

"(12) The term 'debt collection' means that portion of the credit management cycle dealing with recovery of amounts due after routine followup fails, and includes the assessment of the debtor's ability to pay, the exploration of possible alternative arrangements to increase the debtor's ability to pay, and other efforts to secure payment.

"(13) The term 'delinquency' means the status of any account which is 30 days past due.

"(14) The term 'default' means the failure to meet any obligation or term of credit, grant, or contract agreement that causes the lender to accelerate demand on the borrower because of the severity of the borrower's breach of the agreement, and for purposes of this chapter, default occurs—

"(A) In the case of a direct loan, when the account is past due over 180 days; and

"(B) In the case of guaranteed loan, when the Government repurchases the loan.

"(15) The term 'reschedule' means to establish new terms and conditions to facilitate repayment of a debt.

"(16) The term 'referral for litigation' means—

"(A) referral to the Attorney General for appropriate legal proceedings; or

"(B) in any case in which an agency has statutory authority to bring legal actions without referral to the Attorney General, referral to the organization within the agency that is responsible for litigation.

"(17) The term 'credit report' means any written or documented oral communication of information provided by a commercial or consumer credit reporting agency dealing with the credit worthiness or financial reliability of an applicant or debtor.

"SUBCHAPTER II—CREDIT EXTENSION AND ADMINISTRATION

"§ 3811. Subsidy statement

"All legislative proposals for the enactment of new credit programs or the amendment of existing credit programs shall contain an explicit statement of any subsidies in such direct or guaranteed loan programs.

"§ 3812. Interest rates

"Interest rates in all new direct loan programs shall be related to market rates for comparable private sector loan programs, and the interest rates in such direct loan programs shall be adjusted annually to reflect changes in comparable private sector rates.

"§ 3813. Loan origination and application fees

"Loan origination and application fees shall be assessed on all loan or loan guarantee programs to defray administrative costs and costs of defaulted loans.

"§ 3814. Prior default by applicant

"Federal loan or loan guarantee funds may not be made available to any applicant who defaults on a Federal loan or loan guarantee made after the effective date of this section, unless—

"(1) the new loan or loan guarantee is necessary to protect the Government's interests;

"(2) the debt in default was discharged under Federal bankruptcy laws; or

"(3) the default has been cured.

"§ 3815. Default and acceleration clauses

"Loan and loan guarantee contracts shall contain default and acceleration clauses. Default clauses shall provide for interest from the date of default and at the greater of the interest rate due under the existing loan or loan guarantee contract or the rate prescribed by the Secretary of the Treasury under section 3717 of this title. Acceleration clauses shall provide that upon default the entire remaining principal balance shall be due and subject to collection at that time.

"§ 3816. Private sector participation

"The President shall provide for the conduct of a study to determine which Federal direct loan programs could be carried out, in whole or in part, by private lending institutions as direct loans without Government guarantees. Within one year after the date of enactment of this chapter, the President shall transmit to the Congress a report which describes the results of the study and contains such recommendations as the President considers appropriate, including recommendations for legislation.

"§ 3817. Regulations and financial contract

"(a)(1) The Administrator of the Office of Financial Systems shall establish Federal credit management policies and promulgate regulations implementing this subchapter. Such policies and regulations shall apply to direct loans, loan guarantees, loan insurance, financial contracts designed to support borrowing, and debts arising from contracts, grants, and other administrative arrangements. Such policies and regulations shall apply to all executive branch departments and agencies and to Government corporations unless specifically exempted from Federal control by other statutory authority. The Administrator shall include in such regulations any and all credit practices necessary to make Federal credit practices substantially conform to the best established credit practices of the private sector. Such regulations shall include regulations with respect to—

"(A) credit analysis of borrowers (credit worthiness, financial responsibility, and ability to repay determinations);

"(B) program eligibility;

"(C) alternative sources of credit;

"(D) use of taxpayer identification numbers;

"(E) establishment of regular repayment schedules;

"(F) account servicing practices (adequate recordkeeping and documentation, account review and loss estimates, followup procedures on delinquent accounts, and automation of loan servicing activities);

"(G) debt accounting and reporting systems;

"(H) interest, penalties, and administrative costs;

"(I) administrative offset;

"(J) use of collection agencies;

"(K) referral for litigation;

"(L) calling guarantees;

"(M) controlling and foreclosing on collateral;

"(N) Federal employee salary offset;

"(O) income tax refund offset;

"(P) rescheduling;

"(Q) writeoff and closeout procedures;

"(R) portfolio sales;

"(S) management review; and

"(T) improvement plans.

"(2) Regulations promulgated under paragraph (1) of this subsection shall not apply to debts arising under the Internal Revenue Code of 1954, the Social Security Act, the tariff laws of the United States, or to debts owed by State or local governments.

"(b) The Secretary of the Treasury, in consultation with the Administrator, shall prescribe minimum requirements for contracts for all loans or loan guarartees governed by this chapter.

"§ 3818. Effective date

"The provisions of this subchapter shall take effect 90 days after the date of enactment of this chapter.

"SUBCHAPTER III—DEBT MANAGEMENT

"§ 3821. Collection targets

"(a) Each agency which operates credit programs, as part of its budget request (beginning with budget requests for fiscal year 1988), shall develop and specifically identify collection targets for all agency credit programs so that amounts collected may be predicted and used as a source of program funding. To the extent an agency fails to meet its collection targets, program funding shall be reduced by the amount by which the agency fails to meet its collection targets. To the extent that targets are exceeded, 25 percent of the amount that exceeds the target shall be available to the agency as additional program funding.

"(b) Within 180 days of the effective date of this subchapter, the Secretary of the Treasury, in conjunction with the Administrator of the Office of Financial Systems and the Director of the Office of Federal Budget, shall develop and present to the Congress a plan for implementing this subchapter.

"§ 3822. Delinquency and default standards

"(a) Within one year after the date of enactment of this chapter, each agency operating credit programs must develop delinquency and default rate standards for each loan and loan guarantee program and report such standards to the Congress.

"(b) For the first fiscal year beginning two years after the establishment of an agency's delinquency and default rates standard under subsection (a) of this section, and for each fiscal year thereafter, any agency's delinquency and default rates, for loans and loan guarantees made on or after the establishment of the delinquency and default rates, that exceed the respective delinquency and default rate standards shall cause the agency's loan and loan guarantee authority to be reduced in accordance with a formula to be developed by the Secretary of the Treasury, in consultation with the Administrator of the Office of Financial Systems.

"(c)(1) The Secretary of the Treasury shall develop and submit to the Congress, within one year after the date of enactment of this chapter, the formula referred to in subsection (b) of this section. Such formula shall take into account the percentage of deviation from established standards and such other factors as the Secretary considers relevant.

"(2) Any reductions to agency appropriations through application of the formula developed under paragraph (1) of this subsection shall be reported to the Congress by the Secretary.

"§ 3823. Audit of credit programs

"(a) Within two years after the date of enactment of this chapter, the credit management and debt collection systems and operating policies of each agency operating programs must be audited by the Inspector General, or in the case of an agency in which an Office of Inspector General has not been established by law, by an officer of the agency performing functions similar to an Inspector General.

"(b) Each audit conducted under subsection (a) shall determine whether the agency has met the requirements of the Federal Claims Collection Act of 1966, as amended by the Debt Collection Act of 1982, the requirements of this chapter, and the related requirements of the Comptroller General, the Attorney General, the Administrator of the Office of Financial Systems, and the Secretary of the Treasury. Copies of the audit report of each such audit shall be provided to the Congress and the Administrator of the Office of Financial Systems. For any weaknesses disclosed by the audit, the agency head, within 60 days, must furnish the Congress with an explanation as to why the weaknesses exist, and a plan of appropriate action to correct those weaknesses.

"§ 3824. Regulation deadline

"Within one year of the date of enactment of this chapter, each agency operating credit programs shall have promulgated all final agency regulations required by this chapter and the Federal Claims Collection Act of 1966 as amended by the Debt Collection Act of 1982.".

MISCELLANEOUS AMENDMENTS

SEC. 503. (a) Section 3711(f) of title 31, United States Code, is amended by—

(1) striking out "may" after "legislative agency" in paragraph (1) and inserting in lieu thereof "shall";

(2) striking out "may" after "system" in subparagraph (A) of such paragraph and inserting in lieu thereof "shall".

(b) Section 3718(a) of such title is amended by—

(1) inserting "to augment agency collection efforts" after "appropriate"; and

(2) striking out "may" after "head of the agency" and inserting in lieu thereof "shall".

(c) Section 5514(a) of title 5, United States Code, is amended by adding at the end thereof the following new paragraphs:

"(5) This subsection does not apply to intragency deductions for routine administrative overpayments which are the result of clerical or administrative error or delays in the processing of pay documents and which are rarely controversial or disputed. However, even with respect to these routine adjustments of pay, the agency should afford the individual reasonable opportunity to dispute the deduction although this need not be done prior to making the deduction, and should not be done prior to making the deduction if the debtor's employment is about to terminate.

"(6) No claim may be collected under the authority of paragraph (1) of this subsection more than 10 years after it first accrues.".

(d) Section 6103(m)(2)(A) of the Internal Revenue Code of 1954 is amended by inserting before the period a comma and "and other statutory authorities granting agencies independent claims collection authority".

(e) Section 1105(a) of title 31, United States Code, is amended by adding at the end thereof the following new subparagraph:

"(26) a separate statement for each agency operating credit programs detailing the agency's compliance with and activities under chapter 38 of this title and the Federal Claims Collection Act of 1966 as amended by the Debt Collection Act of 1982, which statement shall be filed in a format to be prescribed by the Administrator of the Office of Financial Systems.".

TITLE VI—FEDERAL INFORMATION POLICY

PURPOSE

SEC. 601. The purpose of this title is to improve the management of Federal information resources and activities by (1) amending chapter 35 of title 44, United States Code, relating to the coordination of Federal information policy, and

(2) amending sections 110 and 111 of the Federal Property and Administrative Services Act of 1949, relating to funds for providing telecommunications and automatic data processing resources for Federal agency use in carrying out authorized missions.

INFORMATION COLLECTION PURPOSES

SEC. 602. (a) Section 3501(3) of title 44, United States Code, is amended to read as follows:

"(3) to maximize the usefulness of information collected, maintained, and disseminated by the Federal Government;".

(b) Section 3501(5) of such title is amended to read as follows:

"(5) to ensure that automatic data processing, telecommunications, and other information technologies are acquired and used by the Federal Government in a manner which improves service delivery and program management, increases productivity, improves decision-making, reduces waste and fraud, and, wherever practicable and appropriate, reduces the information processing burden for the Federal Government and for persons who provide information to the Federal Government; and".

DEFINITIONS

SEC. 603. Section 3502 of title 44, United States Code is amended—

(1) by striking out paragraph (4) and inserting in lieu thereof the following:

"(4) the term 'collection of information' means (a) obtaining or soliciting of facts or opinions by an agency through the use of written report forms, application forms, schedules, questionnaires, regulations, or other similar reporting requirements, or (b) requiring persons to create and maintain records through any of the above means, and calling for either—

"(A) answers to identical questions posed to, or identical reporting or recordkeeping requirements imposed on, ten or more persons, other than agencies, instrumentalities, or employees of the United States; or

"(B) answers to questions posed to agencies, instrumentalities, or employees of the United States which are to be used for general statistical purposes;";

(2) by striking out "Management and Budget" in paragraph (8) and inserting in lieu thereof "Federal Management";

(3) by striking out paragraph (11) and inserting in lieu thereof the following:

"(11) the term 'information collection request' means a written report form, application form, schedule, questionnaire, regulation, or other similar method calling for the collection of information or maintenance of specified records;";

(4) by redesignating paragraphs (14) through (16) as paragraphs (19) through (21), respectively;

(5) by redesignating paragraph (13) as paragraph (15);

(6) by inserting after paragraph (12) the following new paragraphs:

"(13) the term 'information resources' includes (A) data and information collected from the public or otherwise obtained or created for agency use or distribution, (B) individuals having information-related skills, (C) information technology resources, and (D) information-related services;

"(14) the term 'information resources management' means the process of—

"(A) defining in a systematic way the information needed to effectively accomplish the authorized agency missions, goals, and objectives;

"(B) managing information resources to efficiently and economically meet the defined information needs; and

"(C) integrating the skills of individuals in the various information resources management functions set forth in section 3504 of this title,

in order to provide for the information needs of the agency in a reliable, accurate, complete and timely manner;";

(7) by striking out paragraph (15) (as redesignated by paragraph (4) of this subsection) and inserting in lieu thereof the following:

"(15) the term 'information system' means (A) a collection of information developed or acquired and maintained through either manual or automated means to fulfill an agency's mission, goals, or objectives, (B) the processes, procedures, and personnel to obtain, maintain, use, and disseminate information, and (C) the related information technology resources employed to maintain the information;"; and

(8) by inserting after paragraph (15) the following new paragraphs:

"(16) the term 'information technology resources' includes information technology hardware, software, and services employed by Federal agencies (that is, automatic data processing, telecommunications, audio, image, and other technology for collecting, processing, storing, and disseminating information);

"(17) the term 'major information system' means an information system that requires special continuing management attention because of its importance to an agency mission; its high development, operating, or maintenance costs; or its significant impact on the administration of agency programs, finances, property, or other resources;

"(18) the term 'managing information resources' extends through the stages of collection or creation, processing, use, dissemination, and disposition of information by agencies and includes the management activities of planning, budgeting, organizing, directing, controlling, and evaluating the use of such resources; the training of personnel resources; and promoting the effective and efficient use of information resources;".

OFFICE OF INFORMATION AND REGULATORY AFFAIRS

SEC. 604. (a) Section 3503(b) of title 44, United States Code, is amended to read as follows:

"(b) There shall be at the head of the Office an Administrator who shall be appointed by the President, by and with the advice and consent of the Senate. The Director shall delegate to the Administrator the authority to administer all functions under this chapter, except that any such delegation shall not relieve the Director of responsibility for the administration of such functions. The Administrator shall report directly to and shall serve as principal adviser to the Director on Federal information policy. The Administrator shall be qualified and experienced in information policy and information resources management.".

(b) The amendment made by subsection (a), insofar as it relates to appointment of the Administrator of the Office of Information and Regulatory Affairs, shall take effect—

(1) immediately after the individual holding that office on the date of the enactment of this section ceases to hold that office; or

(2) on the date of enactment of this Act, if that office is vacant on that date.

FUNCTIONS OF DIRECTOR

SEC. 605. Section 3504 of title 44, United States Code, is amended—

(1) by striking out subsection (a) and inserting in lieu thereof the following:

"(a) The Director shall develop and implement Federal information policies, principles, standards, and guidelines and shall provide direction and oversee the review and approval of information collection requests, the reduction of the paperwork burden, Federal statistical activities, records management activities, privacy and security of records, decision support, agency sharing and dissemination of information, and acquisition and use of automatic data processing, telecommunications, and other technology for managing information resources. The authority under this section shall be exercised consistent with applicable law.";

(2) in subsection (d)—

(A) by striking out "and" at the end of paragraph (3);

(B) by striking out the period at the end of paragraph (4) and inserting in lieu thereof a semicolon; and

(C) by inserting after paragraph (4) the following new paragraphs:

"(5) integrating the functions described in paragraphs (1) through (4) of this subsection with the other information resources management functions established under this chapter; and

"(6) appointing a chief statistician who is a trained and experienced professional statistician.";

(3) in subsection (f), by inserting "and security" after "privacy" in the matter preceding paragraph (1); and

(4) in subsection (g)—

(A) by striking out paragraphs (3) and (4) and inserting in lieu thereof the following:

"(3) providing advice and guidance on the acquisition and use of automatic data processing, telecommunications, office automation, and other information technology (hardware and software), and coordinating, through the review of budget proposals and other methods, agency proposals for acquiring and using such technology;

"(4) promoting the use of automatic data processing, telecommunications, office automation, and other information technology (hardware and software) by the Federal Government to improve the effectiveness of the collection, processing, use, access, and dissemination of data and information in the operation of Federal programs;";

(B) by striking out the period at the end of paragraph (5) and inserting in lieu thereof a semicolon and "and"; and

(C) by inserting after paragraph (5) the following new paragraphs:

"(6) developing guidance requiring that agencies analyze their investments in information technology resources, and establishing that a specified minimum return on investment be met before the agency proceeds with the acquisition of such resources; and

"(7) providing advice and guidance on the use of information technology, including computer models and computer-aided decision support systems, to improve the quality and effectiveness of Federal agency decisionmaking and the ability of the Government to mon tor and analyze information on longer term trends rel vant to agency programmatic and policy decisions.".

ASSIGNMENT OF TASKS AND DEADLINES

SEC. 606. Section 3505(3)(E) of title 44, United State Code, is amended to read as follows:

"(E) develop and annually update based on information supplied by the agencies, and in consultation with the Administrator of General Services, a five-year plan for meeting the automatic data processing, telecommunications, office automation, and other information technology needs of the Federal Government in accordance with the requirements of section 111 of the Federal Property and Administrative Services Act of 1949, as amended (40 U.S.C. 759), and the purposes of this chapter, which plan shall include—

"(i) an analysis of current and projected information technology, software, personnel, and telecommunications trends in Government;

"(ii) an analysis of the implications of major agency information technology plans for security and privacy;

"(iii) the identification of opportunities for use of innovative information technology in carrying out agency missions; and

"(iv) a statement of how the Government will respond to such trends and opportunities; and".

AGENCY RESPONSIBILITIES

SEC. 607. Section 3506 of title 44, United States Code, is amended to read as follows:

"§ 3506. Federal agency responsibilities

"(a) Each agency shall—

"(1) carry out its information management activities in an efficient, effective, and economical manner;

"(2) work diligently to achieve the purposes of this chapter; and

"(3) comply with the information policies, principles, standards, and guidelines prescribed by the Director.

"(b) The head of each agency shall designate, within three months after the effective date of this Act, a senior official or, in the case of the military departments and the Office of the Secretary of Defense, officials who report directly to such agency head to carry out the responsibilities of the agency under this chapter. If more than one official is appointed for the military departments, the respective duties of the officials shall be clearly delineated. Each official designated under this subsection shall be an individual who is a member of the Senior Executive Service or equivalent, who is qualified and experienced in information management, including the planning and coordination of information management programs, and whose primary responsibility is implementing the information management functions of the agency.

"(c) Should the financial budgets of any agency (such as an executive department) be under the direction of, or otherwise administered by, the bureau, administration, or other major subcomponent level, then the head of such bureau, administration, or major subcomponent shall appoint a counterpart official to the senior official appointed under subsection (b) to work with that official to coordinate and insure that the agency's information resources are efficiently, effectively, and economically employed in supporting the accomplishment of the agency's missions, goals, and objectives.

"(d) It shall be the primary responsibility of the agency officials designated under subsections (b) and (c) above to carry out the agency's information management activities. These officials shall—

"(1) organize the agency's information resources management activities so as to achieve the objectives and requirements of this chapter;

"(2) take such actions as may be necessary to assure compliance by the agency with Government information resources management policies and objectives;

"(3) establish and implement agency policies and guidance for the information resources management functions covered by this chapter, including paperwork management, statistical activities, records management, privacy, security, decision support, sharing, and dissemination of information, and information technology functions, which are consistent with the policies, principles, standards, and guidelines issued by the Director;

"(4) develop and annually update the agency's information resources management plan, a component of which is a five-year plan for meeting the automatic data processing, telecommunications, office automation, and other information technology needs of the agency's programs and activities;

"(5) systematically inventory and maintain current, complete records of the agency's information resources, including the number of computers in use, investment in software and telecommunications, and personnel, for use in developing and updating the agency's information resources management plans;

"(6) establish procedures and controls for the review and approval of information collection requests, including regulations containing information reporting or recordkeeping requirements, at the agency level prior to their submission to the Director for approval;

"(7) insure that information collection requests required by law or to obtain a benefit, and submitted to nine or fewer persons, contain a statement to inform the person receiving the request that the request is not subject to the requirements of section 3507 of this title;

"(8) develop procedures for assessing the paperwork, including reporting and recordkeeping, burden of proposed legislation affecting such agency;

"(9) establish such procedures as necessary to ensure compliance of the agency with requirements of the Federal Information Locator System, including necessary screening of the system prior to proposing new information collection requests;

"(10) insure that collections of statistical information for program or agency management purposes are done in accordance with accepted statistical methodology and requirements for statistical surveys prescribed by the Director;

"(11) insure compliance with the laws requiring the maintenance of adequate records covering agency activities as required by chapters 29, 31, and 33 of this title;

"(12) insure compliance with requirements for the security, privacy, confidentiality, and sharing or disclosure of information collected or maintained by or on behalf of the agency;

"(13) be responsible for the conduct of and accountable for any acquisitions made pursuant to a delegation of authority under sections 111 and 205 of the Federal Property and Administrative Services Act of 1949, as amended (40 U.S.C. 759 and 486, respectively) or made under section 2315 of title 10;

"(14) consolidate, review, and approve the budgets of offices and units of the agency for automatic data processing, telecommunications, office automation, and other information technology resources;

"(15) budget and account, separate from the costs of other activities, for the full costs of acquiring and operating information technology resources, including the costs related to protecting security and privacy relative to systems employing such resources;

"(16) require program and agency managers to use specific information technology resources when it is determined that, from an agencywide viewpoint, such use is the most cost-effective method for meeting the program requirements;

"(17) insure that agency information systems do not overlap each other or duplicate the systems of other agencies;

"(18) oversee and coordinate the major uses of computer models and computer-aided, decision-support systems within the agency and maintain an inventory of such uses, including uses that monitor and analyze information on longer-term trends relevant to agency decisions;

"(19) identify opportunities for innovations related to information technology that can improve the agency's ability to accomplish its authorized missions, and provide mechanisms by which such innovations can be analyzed, supported, and shared among and between agencies;

"(20) establish, in coordination with inspectors general or other relevant agency staff, a mechanism for identifying, tracking, and reporting incidents of computer-related fraud and abuse within the agency;

"(21) periodically evaluate and improve as needed the quality (that is, accuracy, completeness, and reliability) of data and records contained within Federal information systems;

"(22) establish an information resources management steering committee, composed of representatives of both officers and employees of the agency who carry out information management activities and who carry out substantive programs, including officers and employees who use the work products generated by agency information systems, to advise the senior official on areas such as the agency information resources management plans, appropriate amounts of information resources to commit to agency programs considering agency priorities, and applications of information technology resources to solve identified problems or improve program operations;

"(23) periodically review, for effectiveness and efficiency, the agency's information resources management activities, including the planning, budgeting, organizing, directing, training, promoting, controlling, and other managerial activities involving the collection or creation, processing, use, dissemination, and disposal of information;

"(24) identify to the Director statutory, regulatory, and other impediments to the efficient management of Federal information resources and recommend to the Director legislation, policies, procedures, or other guidance to improve such management; and

"(25) assist the Director in the performance of the functions of the Director under the Paperwork Reduction Act of 1980 and this chapter, and make agency personnel, services, and facilities available to the Director for this purpose to the extent practicable.".

FEDERAL INFORMATION LOCATOR SYSTEM

SEC. 608. The second sentence of subsection (a) of section 3511 of title 44, United States Code, is amended by inserting before the period a comma and "and shall be designed so as to assist the Federal agencies and the public in locating existing Government information".

RESPONSIVENESS TO CONGRESS

SEC. 609. (a) Subsection (a) of section 3514 of title 44, United States Code, is amended—

(1) by striking out "and" after the semicolon in paragraph (7);

(2) by striking out the period at the end of paragraph (8) and inserting in lieu thereof a semicolon; and

(3) by inserting after paragraph (8) the following new paragraphs:

"(9)(A) a summary of accomplishments and planned initiatives to improve Federal information resources management within agencies;

"(B) a detailed statement, with respect to each agency, of new initiatives to acquire information technology to improve such management; and

"(C) an analysis of the extent to which the policies, principles, standards, and guidelines issued pursuant to section 3504 of this title promote or deter such new initiatives; and

"(10) with respect to the statistical policy and coordination functions described in section 3504(d) of this title—

"(A) a description of the specific actions taken, or planned to be taken, to carry out each such function; and

"(B) a description of the status of each major statistical program, including information on—

"(i) any improvements in each such program;

"(ii) any program which has been reduced or eliminated; and

"(iii) the budget for each such program for the previous fiscal year and the fiscal year in progress and the budget proposed for each such program for the next fiscal year.".

(b) Section 3514 of such title is further amended—

(1) by redesignating subsection (b) as subsection (c); and

(2) by inserting after subsection (a) the following new subsection:

"(b) At the time the President submits the budget for fiscal year 1988, and for each succeeding fiscal year under section 1105 of title 31, the Director shall submit a report to the President of the Senate and the Speaker of the House of Representatives, containing—

"(1) a description of the funds requested in the budget for such fiscal year for each of the following information resources management functions required by this chapter:

"(A) paperwork and regulatory review;

"(B) general information policy, records management, and Federal information access, dissemination, and disclosure policy;

"(C) privacy and security policy;

"(D) statistical policy;

"(E) automatic data processing and telecommunications, and other information technology policy; and

"(F) administrative and other functions;

"(2) a statement of the objectives and goals which the Director intends to achieve during the fiscal year for each of the functions specified in paragraph (1); and

"(3) a description of the allocation of the funds available to the Office of Information and Regulatory Affairs for such functions in the preceding fiscal year.".

AUTHORIZATION

SEC. 610. Section 3520 of title 44, United States Code, is amended to read as follows:

"§ 3520. Authorization of appropriations

"There are authorized to be appropriated to carry out the provisions of this chapter, and for no other purpose—

"(1) $9,000,000 for the fiscal year ending September 30, 1987;

"(2) $9,500,000 for the fiscal year ending September 30, 1988;

"(3) $10,000,000 for the fiscal year ending September 30, 1989; and

"(4) $10,500,000 for the fiscal year ending September 30, 1990.".

INFORMATION TECHNOLOGY FUND

SEC. 611. (a)(1) Section 110 of the Federal Property and Administrative Services Act of 1949 (40 U.S.C. 757) is amended to read as follows:

"INFORMATION TECHNOLOGY FUND

"SEC. 110. (a)(1) There is established on the books of the Treasury an Information Technology Fund (hereinafter referred to as the 'Fund'), which shall be available without fiscal year limitation. There are authorized to be appropriated to the Fund such sums as may be required. For purposes of subsection (b), the Fund shall consist of—

"(A) the capital and assets of the Federal telecommunications fund established under this section (as in effect on December 31, 1986), which are in such fund on January 1, 1987;

"(B) the capital and assets which are in the automatic data processing fund established under section 111 of this Act (as in effect on December 31, 1986) which are in such fund on January 1, 1987; and

"(C) the supplies and equipment transferred to the Administrator under sections 111 and 205(f) of this Act, subject to any liabilities assumed with respect to such supplies and equipment.

"(2) The Administrator shall determine the cost and capital requirements of the Fund for each fiscal year and shall submit plans concerning such requirements and such other information as may be requested for the review and approval of the Director of the Office of Federal Management. Any change to the cost and capital requirements of the Fund for a fiscal year shall be made in the same manner as provided by this section for the initial fiscal year determination. If approved by the Director, the Administrator shall establish rates to be charged agencies provided, or to be provided, information technology resources through the Fund consistent with such approvals. Such cost and capital requirements may include funds—

"(A) needed for the purchase (if the Administrator has determined that purchase is the least costly alternative) of information processing and transmission equipment, software, systems, and operating facilities necessary for the provision of such services;

"(B) resulting from operations of the Fund, including the net proceeds of disposal of excess or surplus personal property and receipts from carriers and others for loss or damage to property; and

"(C) which are appropriated, available under subsection (d), authorized to be transferred, or otherwise made available to the Fund.

"(b) The Fund shall—

"(1) assume all of the liabilities, obligations, and commitments of the funds described in subsection (a); and

"(2) be available for expenses, including personal services and other costs, and for procurement (by lease, purchase, transfer, or otherwise) for efficiently providing information technology resources to Federal agencies and for the efficient management, coordination, operation, and utilization of such resources.

"(c)(1) In the operation of the Fund, the Administrator is authorized to enter into multiyear contracts for the provision of information technology resources for periods not in excess of five years, if—

"(A) funds are available and adequate for payment of the costs of such contract for the first fiscal year and any costs of cancellation or termination;

"(B) such contract is awarded on a fully competitive basis; and

"(C) the Administrator determines that—

"(i) the need for information technology resources being provided will continue over the period of the contract;

"(ii) the use of the multiyear contract will yield substantial cost savings when compared with other methods of providing the necessary resources; and

"(iii) such a method of contracting will not exclude small business participation.

"(2) Any cancellation costs incurred with respect to a contract entered into under this subsection shall be paid from currently available funds in the Fund.

"(3) This subsection shall not be construed to limit the authority of the Administrator to procure equipment and services under section 201 of this Act.

"(d) Following the close of each fiscal year, the uncommitted balance of any funds remaining in the Fund, after making provision for anticipated operating needs, as determined by the Administrator, shall be transferred to the general fund of the Treasury as miscellaneous receipts.

"(e) A report on the operation of the Fund shall be made annually by the Administrator to the Director of the Office of Federal Management and the Director of the Office of Federal Budget and reports shall be prepared on a monthly basis for internal management use. Such reports shall (1) identify Fund expenses by program, by object class, and in summary total, (2) identify any proposed increases to the capital of the Fund, and (3) include a report on information processing equipment inventory, utilization, and acquisitions.

"(f) For the purposes of this section, the term 'information technology resources' includes any service or equipment which had been authorized to be acquired or provided by this section or section 111 of this Act (as in effect on December 31, 1986), and other information processing and transmission equipment, software, systems, operating facilities, supplies, and services related thereto, and maintenance and repair thereof. Section 111 of this Act shall continue to apply to the provision of automatic data processing equipment.".

(2) The table of contents of the Federal Property and Administrative Services Act of 1949 is amended by striking out the item pertaining to section 110 and inserting in lieu thereof the following:

"Sec. 110. Information Technology Fund.".

(b)(1) Section 111 of the Federal Property and Administrative Services Act of 1949 is amended—

(A) by striking out subsections (c) and (d); and

(B) by redesignating subsections (e), (f), (g), and (h) as subsections (c), (d), (e), and (f) respectively.

(2) Section 3504(g) of title 44, United States Code, is amended—

(A) by striking out "section 111(f)" in paragraph (1) and inserting in lieu thereof "section 111(d)"; and

(B) by striking out "section 111(g)" in paragraph (2) and inserting in lieu thereof "section 111(e)".

(3) Section 3(b) of the Paperwork Reduction Act of 1980 is amended by striking out "section 111" and inserting in lieu thereof "sections 110 and 111".

EFFECTIVE DATE

SEC. 612. This title and the amendments made by this title shall take effect on the date of enactment of this Act, except that the provisions of section 611 and the amendments made by such section 611 shall take effect on January 1, 1987.

II

99TH CONGRESS
2D SESSION

S. 2142

To assure the proper budgetary treatment of credit transactions of Federal agencies and to reduce the Federal budget deficit.

IN THE SENATE OF THE UNITED STATES

MARCH 5 (legislative day, FEBRUARY 24), 1986

Mr. TRIBLE introduced the following bill; which was read twice and referred jointly pursuant to the order of August 4, 1977, to the Committees on the Budget and Governmental Affairs with instructions that if one committee reports, the other committee has thirty days of continuous session to report or be discharged

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A BILL

To assure the proper budgetary treatment of credit transactions of Federal agencies and to reduce the Federal budget deficit.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE.

This Act may be cited as the "Loan Accounting Reform and Deficit Reduction Act of 1986".

SEC. 2. FINDINGS AND DECLARATION OF PURPOSES.

(a) FINDINGS.—The Congress finds that—

(1) the Federal Government is a major lender,

(2) loans made by the Federal Government are not adequately coordinated with overall Federal fiscal and debt management policies,

(3) the budgetary treatment of such loans fails to depict their cost to the Federal Government in an accurate or timely manner, and

(4) the sale of newly originated Federal loans can reduce substantially the budget deficits of the Federal Government.

(b) PURPOSES.—The purposes of this Act are to assure coordination of Federal and federally assisted borrowing programs with the overall economic and fiscal policies of the Federal Government and to assure that the budgetary treatment of such programs accurately reflects their cost to the Federal Government.

SEC. 3. DEFINITIONS.

FOR PURPOSES OF THIS ACT—

(1) The term "Federal agency" means an executive department, an independent Federal establishment, or a corporation or other entity established by the Congress that is owned in whole or in part by the United States.

(2) The term "obligation" means any note, bond, debenture, or other evidence of indebtedness, but does

not include Federal Reserve notes or stock evidencing an ownership interest in the issuing Federal agency.

(3) The term "direct loan" means a disbursement of funds by a Federal agency (not in exchange for goods or services) under a contract that requires the repayment of such funds with or without interest. Such term shall also include an obligation guaranteed by a Federal agency and purchased by the Federal Financing Bank. Such term shall not include any commodity price-support loan made by the Commodity Credit Corporation.

(4) The term "subsidy" means, with respect to a direct loan, any excess of the amount loaned over the price at which such loan is sold under section 5.

SEC. 4. FUNCTIONS OF FEDERAL AGENCIES.

(a) TRANSMITTAL OF LOAN OBLIGATIONS TO THE TREASURY.—Notwithstanding any other provision of law, any Federal agency that after October 1, 1986, makes a direct loan shall (as soon as practicable after making such loan) transmit to the Department of the Treasury—

(1) the loan obligation, and

(2) such information with respect to the borrower as may be necessary for the Department to sell the obligation under section 5.

Notwithstanding any other provision of law, any information received by the Department under paragraph (2) may be disclosed by the Department to the extent necessary to sell the obligation under section 5.

(b) USE OF STANDARD CONTRACT.—To the extent practicable, any Federal agency, when making a direct loan, shall use the appropriate standard contract formulated by the Department under section 5.

SEC. 5. FUNCTIONS OF THE DEPARTMENT OF THE TREASURY.

(a) IN GENERAL.—Notwithstanding any other provision of law, within ninety days after a Federal agency has made a direct loan, the Department of the Treasury (acting as agent for such agency) shall sell the obligation resulting from such loan (either directly or through pooled participation arrangements). All sales under this section shall be made to the highest bidder at a public auction conducted by the Department or an agent of the Department.

(b) LIMITATION ON POOLED PARTICIPATION ARRANGEMENTS.—Pooled participation arrangements may be used by the Department only to the extent that such arrangements permit the proper allocation of subsidy costs to the appropriate budget account.

(c) OBLIGATIONS SOLD NONRECOURSE.—All obligations sold under this section shall be sold without recourse to the Federal Government and no guarantee by a Federal agency of such an obligation shall be effective.

(d) OTHER DEPARTMENT FUNCTIONS.—

(1) The Department shall collect a fee from the agency making the loan to cover all of its costs of acting as agent in selling such obligation.

(2) In order to facilitate the sales of direct loans, the Department (in consultation with the Office of Management and Budget) shall formulate standard contracts to be used by Federal agencies when making direct loans.

(3) The Department shall report annually to the Congress on all loan sales under this section. Such report shall include recommendations to improve the market acceptance of future Federal loans.

SEC. 6. BUDGETARY TREATMENT.

(a) SUBSIDIES TREATED AS OUTLAYS.—For Federal budgetary purposes, in the case of any direct loan made by a Federal agency after October 1, 1986 (including an obligation guaranteed by a Federal agency and purchased by the Federal Financing Bank), the subsidy (and only the subsidy) shall be treated as an outlay made by such agency.

(b) LOANS SUBJECT TO LIMITS IN APPROPRIATION ACTS.—A Federal agency may make a direct loan after October 1, 1986, only to the extent that an appropriation has been made to the agency for the subsidy (or, in the case of a loan made without a direct appropriation, only if a limit on the amount of such loans has been established in an annual appropriation Act).

SEC. 7. LOAN SERVICING.

Nothing in this Act shall be construed as changing the responsibility for servicing direct loans made by a Federal agency or as changing the terms and conditions of eligibility for, or the amount of assistance provided by, loans made by the Federal Government.

SEC. 8. EXEMPTION FROM SECURITIES LAWS.

Any direct loan or other obligation sold under this Act shall be an exempted security within the meaning of section 3(a) of the Securities Act of 1933 and section 3(a)(12) of the Securities Exchange Act of 1934.

SEC. 9. EFFECTIVE DATE.

(a) The amendments made by this Act shall take effect on October 1, 1986; except that section 5(d)(2) (relating to formulation of standard contracts) shall take effect on the date of the enactment of this Act.

Statement by Hon. Bill Gradison on S2142,
"The Loan Accounting Reform and Deficit Reduction Act of 1986"
before the Senate Government Operations Committee
(May 13, 1986)

I am pleased to join Sen. Trible today in support of his bill, S.2142. I commend you, Mr. Chairman, for holding this hearing and especially for your efforts to improve the management of the federal government.

As a result of this hearing, I hope you'll find that S.2142 is both compatible with and complimentary to your more comprehensive legislation -- **"The Federal Management Reorganization and Cost Control Act of 1986"** -- and that you will incorporate S.2142 into your bill.

Mr. Chairman, the most important requirement for sound management is good information. This is equally true for policymaking. Yet, one area of government -- federal credit programs -- stands out for its demonstrably poor quality of information. We know, for example, that the federal government originated $53 billion in direct loans last year, but we can only guess as to the cost of these loans.

In fact, the situation goes beyond poor quality of information because the information we do have actually misrepresents the facts.

Of course, if credit programs were costless, this would be little more than academic interest. Certainly, we do hear assertions that government credit does not involve cost, since loans are usually paid back with interest. This argument is absurd on its face; if loans are costless, why not convert all government programs to loans!

Moreover, the extension of government credit under terms and conditions more favorable than a recipient can otherwise receive constitutes an uncompensated risk borne by all Americans whether or not the loan is repaid with interest. Furthermore, by moving recipients to the head of the credit line, government credit programs necessarily rearrange the pecking order for creditworthiness, causing some to pay less and some more for credit. This is surely the consequence, if not the intent, of the public policies. It means that, as a matter of policy, we are reordering the allocation of resources within our economy.

I would stress that there is nothing inherently wrong with this; after all, that's the purpose of government programs -- to provide a benefit, or otherwise convey a subsidy. The issue is not whether a subsidy is involved, but rather what the subsidy is.

The problem arises because current budget practices record loan disbursements as current year outlays. This obviously overstates their true cost. On top of this, outlays for direct loans are offset by repayments (from these and previously-made loans) which further muddies the situation. Can you imagine a bank recording its lending activities this way?

The sole purpose of S.2142 is to correct this problem by reflecting in the budget the actual subsidy of direct loans. It would do so by requiring the government to employ practices that are commonplace and routine in the private financial sector.

In order to determine the true subsidy value, S.2142 would require that new direct loans be sold to the public without a government guarantee. This is consistent with economic theory and common sense, both of which tell us that the discount demanded by the market -- that is, the difference between the loan's face value and its selling price -- is the value of the subsidy conveyed. This is why we call it the "Market Plan."

The Market Plan reflects my view that values are best determined by free markets. And financial markets are the most efficient markets. As a businessman from the field of investment finance, I know this principle can be put to work in the interests of better management of the federal government.

Mr. Chairman, in the interests of time, I would like to focus on three key points. Before doing so, I would like to call your attention to my Record statement of introduction for H.R.4324 [page E641, March 5, 1986], the companion bill for S.2142, which I have attached to these prepared remarks.

The first point concerns the necessity of selling loans without a federal guarantee. The objective of the Market Plan can only be realized if the loans are sold without recourse. If loans are sold with recourse, we merely raise the cost of the programs while moving the cost completely off the federal books. It is a double whammy, and, needless to say, we are still in the dark with respect to subsidy costs.

The problem can be traced to the absence of credit considerations in the 1974 Budget Act. The explosion of federal credit in the 1970s can be attributed in no small part to the constraints put on "regular" (non-credit) spending by the Budget Act of 1974. The loopholes enjoyed by credit programs were closed, or so we thought, by Gramm-Rudman-Hollings which requires that all agency transactions with the off-budget Federal Financing Bank be recorded on budget and in the accounts of the agency actually conducting the program.

But as the ink was still drying on Gramm-Rudman-Hollings, Congress legislated exceptions to this change. In H.R. 3128, the recently-passed reconciliation bill, exceptions were carved out for the rural housing and SBIC loan programs. As a result, these programs are now prohibited from using the FFB; instead, they must use private financing, but with a government guarantee. The upshot is that these programs are now more costly while at the same time appearing costless. These programs have also been given a valuable form of protection from oversight -- out of sight, out of mind! Attached to this testimony is a brief discussion of these two changes in more detail.

And, the Administration has also tried accounting legerdemain to hide the true costs of credit programs. A good example is their proposal for treating the Export-Import Bank's direct loan program which would reclassify the activity from a direct loan to a "guarantee" program. [see point 3 at the end of these prepared remarks for a more detailed explanation.]

In short, Mr. Chairman, the incentives to misstate true costs are greater now because of the public's strong concern over the deficit as well as changes intended by Gramm-Rudman-Hollings. There is a strong push to hide the true costs and nature of federal credit programs by substituting financing from the public for financing from the Treasury. Yet, a promise by the government to stand behind the principal and interest of a private note is no different than a direct government loan, and it ought to be reflected that way in the federal budget.

My second key point concerns implementation of the Market Plan. I would acknowledge that as presently drafted, the Market Plan is over ambitious. For one thing, it would require all new loans to be sold; clearly, this is more of a theoretical ideal rather than a practical possibility. If only for political reasons, it will be necessary to pilot test the Market Plan with a limited number of loan programs.

In addition, in order to maximize the return to the government, it will be necessary to provide considerable "structure" to the loan assets. This includes standardizing loan contracts for specific programs and selling them in pools. It should go without saying that agency requests and justifications for appropriations should be dramatically improved so that the assets can be rated in a way useful to potential investors. We must also determine the best way to manage the Market Plan in the Executive Branch (within and between various agencies). Much of this, I think, can be delegated to the Executive, but whether dictated by Congress or delegated by Congress, we must ensure substantial input from those in the private sector who are far more knowledgable about and experienced with financial asset sales.

Importantly, these considerations need not and should not delay incorporation of the Market Plan into your more comprehensive legislation. I would argue that we should know the subsidy before we raise or cut it. Yet, we see today several proposals that would alter subsidies by changing various terms and conditions such as origination and application fees, default and acceleration clauses, private participation requirements, and the like. To me, these proposals put the cart before the horse; we are making policy in the dark.

Moreover, I would argue that the Market Plan is essential to meet the requirements of your proposed legislation. Specifically, section 3811 (subchapter II, Title V) would require all legislative proposals for new credit programs "to state any subsidies in direct or guaranteed loan programs." In frankness, I don't see how this provision can be meaningful without experience gained by actual sales of government financial assets which the market plan would provide.

Finally, Mr. Chairman, I want to stress what the Market Plan would and would not do:

- o it would determine the true subsidy costs of federal direct loan programs; in the process, it would correct the current overstatement of the cost of federal credit programs; as a result, the deficit would be reduced (the consequence of accelerating repayments of the loans);
- o from the fiscal policymaking perspective, the Market Plan would require Congress to recognize the cost of credit programs before providing their budgetary resources (budget authority); needless to say, managers of the programs, as well as beneficiaries and the general public, would know the cost of these programs, and these costs would, for the first time, be commensurate with non-credit outlays in the budget;
- o the Market Plan would not change the terms of any credit program; it is not privatization; and agencies would continue to select beneficiaries;
- o importantly, there need be no loss of government discretion over matters such as forbearance; to the extent such terms and conditions are articulated in the contracts, they would be relected in the discount;
- o the Market Plan excludes CCC "loans" (because they are not really loans, but rather deferred purchase agreements) nor does it include the activities of government-sponsored enterprises such as Fannie Mae or Sally Mae; nor does the Market Plan provide for selling the government's existing loan portfolio (only new loans would be sold);

In short, Mr. Chairman, the Market Plan would dramatically improve the quality of both policymaking and management of the federal government. Thank you for inviting me to appear before your committee. I will be glad to respond to any questions.

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attachment

Examples relating to the Farmers Home Administration and Small business investment companies (SBIC program), and Export-Import Bank direct loan program.

1. Farmers Home Administration. FmHA originates home mortgages for low income borrowers. FmHA loan disbursements are outlays of the federal government and add to the deficit. The Reconciliation Act of 1985 requires FmHA to sell all newly-originated rural housing loans to the public. These loans are to be sold "with recourse", a type of federal guarantee that requires the government to repurchase any loans which default. The intent is that these loan "sales" should generate offsetting collections (akin to accelerated repayments) equal to the amount loaned so that the net budget cost of new FmHA loans can be recorded as zero. Yet, and despite this rather significant change in budget accounting, no material change would occur in the FmHA program.

2. SBICs have been able to borrow from the FFB on the strength of a 100 percent guarantee from the SBA. Under Gramm-Rudman-Hollings, however, the FFB has been brought on-budget so that SBA-guaranteed loans disbursed by the FFB are scored as SBA outlays. Yet, H.R. 3128 requires that SBICs avoid financing these loans with the FFB and instead place their 100 percent guaranteed debt directly in the capital markets. By circumventing the FFB, the intent is to reduce SBA/FFB federal outlays by the amount of the loan disbursements without reducing SBA's liability or costs.

3. Eximbank makes loans to selected foreign buyers of U.S. goods at subsidized interest rates. Eximbank loan disbursements are government outlays which increase the deficit. The president has proposed to have commercial lenders make the loans now made by Eximbank, with the agency guaranteeing the loan and paying the lender a subsidy sufficient to reduce the loan rate to that currently charged by Eximbank on direct loans. Under this proposal, the subsidy would be paid out over the life of the loan so that little would be recorded in the budget this year. By reclassifying this activity as a "guarantee" rather than a "direct loan", proponents hope to reduce the budget cost of the program without reducing the value of the subsidy to beneficiaries. In fact, because the cost of money to commercial lenders is greater than the cost of money to the Treasury -- which finances Eximbank lending -- this proposal would actually increase the cost of the program to the government.

Congressional Record

March 5, 1986 — Extensions of Remarks — E 641

THE NEW MARKET PLAN

HON. WILLIS D. GRADISON, JR.

OF OHIO

IN THE HOUSE OF REPRESENTATIVES

Wednesday, March 5, 1986

Mr. GRADISON. Mr. Speaker, today I am introducing a revised version of the "Market Plan," legislation which will efficiently and accurately determine the true costs of Federal credit programs. Senator TRIBLE is introducing similar legislation in the Senate.

The "new" Market Plan represents an improvement over its predecessors (H.R. 4629 in the 98th Congress and H.R. 1216 in this Congress). Revisions stem from comments from many individuals and groups, both inside and outside the Congress. But the underlying goal of the Market Plan has not changed—to report in the unified budget the true subsidy costs of Federal credit programs.

The Market Plan takes on new meaning in these times of Gramm-Rudman because the Market Plan would reduce the deficit by $67 billion over the next 5 years. The following estimates were prepared by the Congressional Budget Office:

DEFICIT REDUCTION IN BILLIONS

	Annual	Cumulative
1987	[illegible]	[illegible]
1988	[illegible]	[illegible]
1989	[illegible]	[illegible]
1990	[illegible]	[illegible]
1991	[illegible]	[illegible]

The costs of administering the Market Plan are assumed to be part of the subsidy cost charged. It should be noted that these estimates are based on a number of simplifying assumptions. The extent of the subsidies can only be verified through the actual sale of the loans.

This deficit reduction is not done with blue smoke and mirrors. The Market Plan reduces the deficit honestly and truly through widely-accepted and commonly-employed principles of finance. It does so by accelerating repayments for new loans; repayments for old loans would continue to come in. Let me point out, however, that I am not advocating substitution of the Market Plan for "conventional" deficit reduction; the deficit reduction results from the Market Plan shifting of portfolio ownership (without recourse) from the public to the private sector.

The Market Plan would operate by requiring that new direct Government loans (not loan guarantees) be sold in the highly efficient financial marketplace, just as billions of dollars of similar financial assets are sold every working day. The discount demanded by the market, the difference between the face value and the selling price, is the subsidy conveyed by the American people to the beneficiary of the Government loan. Under the Market Plan, the discount would be scored as an outlay of the agency advancing the loan.

It is also important to note what the Market Plan would not do:

The Market Plan would not change the terms to any credit program. Lending agencies would continue to select beneficiaries and provide them with loans and guarantees.

The Market Plan would not "privatize" Federal credit programs. It would utilize the private capital markets in order to determine the costs of credit programs.

The Market Plan would not change the manner in which credit assistance programs receive their budgetary resources (namely, budget authority).

The Market Plan would not require or authorize the sale of the Government's existing loan portfolio.

The Market Plan would not cover Commodity Credit Corporation (CCC) loans (which are not, in fact, loans, but deferred purchase agreements) or Government-sponsored enterprises such as Fannie Mae or Sally Mae.

In short, the Market Plan corrects the flaws in the current budget accounting system. It does so by forcing the budget and the Congress to recognize the true costs of direct loans [redacted] prior to the commitments to provide this assistance; that is, when costs are still under congressional control.

[From the Congressional Record, Mar. 5, 1986]

By Mr. TRIBLE:

S. 2142. A bill to assure the proper budgetary treatment of credit transactions of Federal agencies and to reduce the Federal budget deficit; pursuant to the order of August 4, 1977, referred jointly to the Committee on the Budget and the Committee on Governmental Affairs.

LOAN ACCOUNTING REFORM AND DEFICIT REDUCTION ACT

Mr. TRIBLE. Mr. President, each year the Federal Government lends huge sums of money to selected borrowers. In 1985, for example, our Government made $53 billion in new loans. Projections by the Office of Management and Budget suggest that new Federal direct loans will average $37 billion per year over the next 3 years.

Federal direct loans are usually subsidized loans, conveying payments from taxpayers to assisted borrowers. These subsidies may be given through below-market interest rates, deferred or forgiven loan repayments, or through other noncommercial terms and conditions such as waiver or reduction of loan fees.

Given the huge sums involved, Congress and the American people need to know how much money is being spent in this way.

Unfortunately, Congress presently has no idea of the subsidies conveyed, and the costs incurred, when new loans are made. Yet these subsidies are substantial: OMB estimates that $9.8 billion in subsidies were distributed by new Federal loans during 1985, and that $9.2 billion will be given away this year.

Congress' stunning ignorance about loan program subsidies and costs makes it impossible for Congress to evaluate individual loan programs, to compare the tradeoff loan programs against other Federal expenditures, or to determine overall budget and loan policy in a rational manner.

Today, along with Representative BILL GRADISON in the House, I am introducing legislation to reform budget accounting for new direct Federal loans through loan sales. Our bill will provide Congress with the information it desperately needs concerning the true cost of such activities, and will bring those costs into the Federal budget. And because the current budget net lending overstates the true cost of new loans, selling loans and substituting an accurate cost measure will also reduce the budget deficit by up to $67.4 billion over the next 5 years.

To reform budget accounting for new loans in order to identify their true subsidy cost, and to reduce the Federal budget deficit, new loans made in the future would immediately be sold, without a Federal guarantee, to the high bidder in a competitive auction. The amount raised by selling a loan would be subtracted from the amount lent, and the difference—an objective measure of the subsidy cost of the loan—would be included in the Federal, and agency budgets.

Selling loans to identify subsidies was suggested by the Congressional Budget Office in its 1984 study, "New Approaches to the Budgetary Treatment of Federal Credit Assistance."

If our bill is adopted, Congress and the public will know, for the first time, what Federal loans truly cost. As a result, Congress will be better able to evaluate individual loans programs; to compare loans with other Federal spending programs, and to set overall budget and loan policy in a more intelligent way. In addition, because loan costs will be accurately reflected in the budget when loans are made, Congress will have a powerful incentive to use the cost information provided—an incentive it now lacks. The Federal deficit will be reduced immediately by loan sales, and pressure will be created to restrain long-term loan program giveaways.

"NET LENDING": THE NEED TO REFORM BUDGET CONCEPTS

Our bill would replace the current budget concept of "net lending"—which gives an inaccurate and misleading measure of the cost of new loans—with an accurate and informative measure of the subsidy cost of new leading. Correcting the current budget distortion would also reduce the budget deficit.

Present budget accounting uses a concept called "net lending" to portrary Federal loan activity. As its calculation makes clear, "net lending" does not—and cannot—accurately portray the cost of new loans.

For an individual loan program, "net lending" is calculated as follows:

Net lending equals outlay for new loans made this year plus outlays to honor past guarantees, on loans defaulted this year minus repayments of past loans minus receipts from sales of old or new loans.

To illustrate the calculation of "net lending," suppose a Federal agency makes new loans of $5 billion, pays $1 billion to honor prior guarantees on loans defaulted this year, receives $1 billion in repayments of old loans, and sells $1 billion in old loan assets. Its "net lending" would be $4 billion (=5+1−1−1), and this figure is the net outlay which would be shown in the agency's budget and in the agency's accounts in the Federal budget.

Since at least two of the four components of "net lending" refer to past credit activities, it is obvious that "net lending" cannot and does not measure the cost of new loans extended in the current year.

Using "net lending" as a budget measure is extremely misleading: It can make high cost programs, look cheap, and make low cost programs seem expensive.

For example, a loan program with a large volume of new, heavily subsidized loans will appear inexpensive if its "net leading" figure is reduced by large repayments of earlier loans. Similarly, a new loan program with a moderate volume of unsubsidized loans can appear more expensive than it is, simply because there are no offsetting repayments of earlier loans to reduce its "net landing" should be rejected because it does not accurately reflect the cost of new Federal loan activity.

LOAN SALES AND THE TRUE COST OF FEDERAL LOANS

To understand the accounting reform we are proposing, it is necessary to understand first what the true cost of a subsidized loan is, and, second, how loan sales can reveal that cost.

The cost of a subsidized loan is the amount lent minus the present value of expected future loan repayments. This difference is the loan's subsidy or cost:

Loan cost = amount lent − present value of expected future repayments.

If $50 million is lent, and repayments worth only $40 million are expected, the Government is effectively providing a $10 million subsidy, and incurring a $10 million cost.

If a loan is sold to the highest bidder a competitive action, its sales price will approximate the present value of expected repayments.

Sales price = present value of expected future repayments.

Thus, once a loan is sold—and the present value of expected repayments is revealed by the market—the loan subsidy or cost can be simply determined as the difference between the amount lent and the loan's sales price:

Loan cost = amount lent—sales price.

As OMB states in this year's budget documents "the discount from the face value of the loan provides an unambiguous measure of the subsidy of the loan."

PROPOSAL: SELLING NEW LOANS

Budget accounting reform to reflect new loan subsidy costs would be achieved as follows. The Government would make new loans and incur loan outlays as it now does, but would then auction the loans to determine their value. Each loan would be sold to the highest bidder. For each loan, receipts from the loan sale would be "offsetting receipts" which would be subtracted from the principal amount lent on the lending agency's books. In this way, the agency's budget would include the subsidy cost of new loans. The annual total of such subsidies would be controlled by appropriations. During the year, the agency would make and sell loans—and incur subsidy costs—up to its appropriation.

By this procedure, all subsidies would be attributed to the appropriate loan program and agency, included in the Federal budget, and controlled by appropriations as other forms of direct spending are.

NEW LOAN SALES REDUCE THE DEFICIT

Our bill relies on sales of new loan assets to reform budget accounting. But loan sales also generate receipts which reduce the Federal budget deficit. Thus, a principled and needed accounting reform can incidentally contribute to deficit reduction, and can reduce the need for painful short-term budget cuts.

Congressional Budget Office analysts have tentatively estimated the budget impact of our proposal, assuming all new loans are sold starting in fiscal 1987. They find that loan sales would reduce baseline deficits by up to $67.4 billion over the next 5 years. This is an average annual deficit reduction of about $13.5 billion for the next 5 years.

Our proposal can be viewed in another way. Reforming budget accounting to eliminate the meaningless concept of "net lending," and substituting a proper measure of loan subsidy costs, would eliminate the present budgetary overstatement of the cost of Federal loans. This overstatement artificially inflates the Federal budget deficit. If left uncorrected by loan sales, this overstatement would force larger-than-necessary "Gramm-Rudman" budget cuts to balance the budget. While we certainly want to balance the budget, we have to make sure it is the true budget we balance, rather than a budget artificially inflated by faulty accounting.

WHAT OUR BILL DOES NOT DO

Our proposal would not change any Federal loan program, Loans could continue to be made as they now are, on the same terms and conditions as at present. Borrowers helped by Federal loan programs need suffer no loss of assistance, no change in eligibility for aid, and no change in repayment responsibilities.

The proposal simply generates timely and reliable information on program costs; it does not change the underlying loan programs.

Our proposal also differs from recent proposals to sell existing Federal loan assets with a Federal guarantee. Our bill is prospective only: We do not suggest selling existing loans, only future loans. And our bill requires loans to be sold without a Federal guarantee. Sales without guarantee are essential if the prime purpose of the bill—revealing the subsidy cost of Federal loans—is to be achieved.

We are opposed to selling existing loan assets with a Federal guarantee solely for the purpose of reducing the Federal deficit on paper. Sales with a guarantee are an inefficient and costly substitute for financing deficits through Treasury securities. And, as Martin Feldstein has noted, guaranteed loan assets sales "would be no different from the sale of more Government bonds * * * and would do nothing to lessen the burden of the deficit. They would preempt private savings every bit as much as a Federal sale of new debt of the same value."

Our proposal meets Feldstein's criticism. Our purpose is to correct an improper budget concept, and to provide Congress with needed information. This information on loan costs can create real pressure to reform and restrain future subsidies. That selling new loans incidentally generates deficit reduction is not a criticism of our proposal, since the current budget concept of "net lending" effectively overstates the true deficit by improper accounting. Our bill merely eliminates this distortion.

I urge my colleagues to support the Loan Accounting Reform Act.

JOHN R KASICH
12TH DISTRICT OHIO

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REMARKS BY CONGRESSMAN JOHN R. KASICH BEFORE THE
SENATE GOVERNMENTAL AFFAIRS COMMITTEE

MAY 13, 1986

Mr. Chairman, I would like to thank you for providing this opportunity to express my views regarding the need to improve the Federal government's ability to collect delinquent debt. Your interest and leadership in this very important issue are highly commendable. I am also encouraged that these hearings, as well as those recently held in the House, will lead to enactment of major improvements in debt collection.

As the prime sponsor of comprehensive debt collection legislation (H.R. 4659), I strongly believe the government's debt collection and credit management procedures need to be reformed and greatly strengthened. Mr. Chairman, the Federal government is owed $60-$70 billion in overdue debt, an amount that is growing at a rate of over $50 million per day. While the single largest amount owed—some $35-$40 billion—is primarily due the Internal Revenue Service for back taxes, the remaining balance of $25-$30 billion is spread literally throughout the entire Federal government. In other words, the sheer width and breadth of the overdue debt problem is just as astonishing as the amount which is overdue. A review of delinquencies reveal that government makes financial assistance available to just about everyone to do just about anything. However, in far too many cases, government loan and credit assistance programs have only been concerned with providing financial help as quickly as possible. With so much emphasis being placed on spending taxpayers' money, little or no consideration has been given on how to efficiently collect what is due.

Although much public attention has been given to student loan defaults, as well as programs within the Department of Housing and Urban Development and the Small Business Administration, delinquent debt problems are prevalent throughout almost every agency. A sample of these delinquent debts include:

* $27 million in the National Oceanic and Atmospheric Administration vessel financing fund, which is due to commercial fishermen defaulting on guaranteed financing that was used for the purchase or repair of fishing vessels and related shoreside facilities;

* $68 million in the Department of Defense's Selective Reenlistment Bonus program is due from skilled personnel who received bonuses to reenlist, but then left the service before their tour of duty was completed;

* $30 million from the Department of Health and Human Services' Health Corps Scholarship Fund, which provides medical students aid who promise to practice medicine in areas with doctor shortages, from doctors who reneged on their commitment;

* $374 million in the Maritime Administration's federal ship financing fund, which represent a series of loans, loan guarantees, tax deferrals, and other assistance, and been subject to many critical comments and was found to have provided financing for purposes not authorized by program laws and regulations;

- * $209 million from uncollected timber, mineral and surface mining fees and fines by the Interior Department;
- * $106 million in unpaid import duties by the U.S. Custom Service; and
- * $11 million in travel advances to State Department employees for which employees have not yet turned in vouchers, or unused travel funds which should be returned to the government.

Despite Congress enacting the Debt Collection Act of 1982, the above examples clearly show the Federal bureaucracy is still experiencing major problems in debt collection. Since Fiscal Year 1982, overdue debt has almost doubled and the amount of delinquencies continues to grow. It should also be noted that the Federal government wrote off over $3.5 billion in delinquent debt last year with no clear assurance that every possible action was taken to collect this debt. Furthermore, with over $345 billion now outstanding and another $600 billion in loan guarantee commitments, the potential for the Federal government's debt problem to continue escalating is enormous. At a time when Gramm-Rudman-Hollings is forcing Congress to examine all Federal spending programs, I find it inconceivable that appropriations for popular programs will be cut, yet billions of dollars owed the Federal government continues to be uncollected. Congress can no longer afford to permit these funds to remain uncollected, and immediate action is essential if the problem is going to be brought under control.

Based on my research and the valuable assistance provided by the General Accounting Office, I have found the government's debt collection crisis is primarily due to several major factors including (1) improper screening of participants in loan programs, (2) incompetent administration of loan portfolios of those who have the ability to repay the debt, (3) insufficient use of private collection agencies and other means to ensure collection from delinquent debtors, (4) lack of resources dedicated to litigation efforts and enforcement of court judgments, (5) lack of intragovernmental cooperation to obtain current debtor information, and (6) inadequate accounting methods and systems.

According to my discussions with GAO staff, most government agencies have such inadequate internal accounting controls that in many instances there is very little information available on the status of debts and whether it is collectable. Without such a basic accounting framework, it is not surprising that a recent GAO study found 11 agencies (Agriculture, Commerce, Defense, Education, HHS, HUD, Justice, Labor, Interior, SBA, and Transportation) reporting major problems in debt collection. Collectively, these agencies administer about 92 percent of the government's delinquent non-tax debts. Furthermore, although conformity with the Comptroller General's accounting requirements was mandated by Congress 35 years ago, another GAO report discovered that Federal agencies indicated that 226 of 427 accounting systems, or 53 percent, were not in conformity with these standards.

In other agencies where appropriate debt information can be provided, bureaucratic delays and lack of litigation resources have hampered collection efforts. Although the Debt Collection Act of 1982 took an important step by authorizing agencies to use private collection services, it took almost three years for the bureaucracy to write the necessary regulations to implement this provision. The significance of this delay is further magnified when you consider that delinquencies almost doubled during this same period. In addition to private collection agencies, an another important tool in improving collection efforts is the ability to use legal suits to force payments. The Department of Justice's litigation efforts, however, have been slow, ineffective, and inefficient. In fact, the Justice Department has a backlog of 95,000 debt cases and it increased by 16,000 cases last year alone.

Due to the complexity of the debt collection crisis and the multitude of problems involving current bureaucratic procedures, I am convinced that only a comprehensive response by Congress will dramatically improve collection efforts. In my opinion, any solution to the delinquent debt problem must contain these following components: 1) appointment of a "debt czar" who would be ultimately responsible for debt collection and credit management throughout the Federal government; 2) mandate all agencies to establish specific management systems to ensure proper and timely administration of credit assistance and debt collection; 3) require the adoption of current collection practices used in the private sector and the sale of debt portfolios to private investors or collection agencies; 4) provide additional tools to the Justice Department and other agencies to ensure that debt collection efforts are enhanced by appropriate litigation efforts; 5) enactment of new statutes that prohibit delinquent debtors from continuing to receive additional Federal assistance; 6) provide budgetary incentives for Federal agencies to improve debt collection; and 7) facilitate the sharing of debt-related information between government agencies to ensure timely collection.

I am very pleased that many of these components are included within Title V of S. 2230 and I urge the Committee to give these proposals very serious consideration. I am particularly supportive of provisions that require Federal agencies to use private collection agencies, establish debt collection targets for each agency, and expand the ability of the Internal Revenue Service to provide taxpayer information to agencies pursuing debt collection activities. Another positive feature within Title V is the recognition that someone must be coordinating and supervising the government's credit assistance and debt collection programs.

Mr. Chairman, thank you again for this opportunity to provide my views on this very important problem and I hope my comments have been helpful. My only hope is that I have convinced the Committee how essential it is for Congress to statutorily address the delinquent debt problem. While the promulgation of regulations can play a role, it is apparent that many needed reforms must be codified to ensure their implementation. Only strong Congressional action will force Federal agencies to devote more resources to debt collection and I urge this Committee to take immediate action.

PREPARED STATEMENT OF CONGRESSMAN BEAU BOULTER

CHAIRMAN ROTH, MEMBERS OF THE GOVERNMENT AFFAIRS COMMITTEE, I AM HONORED TO HAVE THE OPPORTUNITY TO APPEAR BEFORE YOUR DISTINGUISHED COMMITTEE TODAY. CHAIRMAN ROTH, I WANT TO COMPLIMENT YOU FOR CALLING THESE HEARINGS TO ADDRESS THE CONCEPT, AND MORE IMPORTANTLY THE NEED FOR, IMPROVEMENT IN THE WAY OUR FEDERAL GOVERNMENT MANAGES ITS FINANCIAL RESOURCES.

YOUR COMMITTEE HAS NO MORE IMPORTANT RESPONSIBILTY THAN ITS OVERSIGHT OF THE OFFICE OF MANAGEMENT AND BUDGET, AND THE FEDERAL BUDGET PROCESS. THIS RESPONSIBILITY WILL PROVE TO BE OF UTMOST IMPORTANCE AS WE MOVE FURTHER INTO THE ERA OF GRAMM-RUDMAN-HOLLINGS, WITH THE BUDGET PROCESS, OUR COUNTRY'S FINANCIAL MANAGEMENT SYSTEMS, AND THE OFFICE OF MANAGEMENT AND BUDGET ALL BEING TESTED AS NEVER BEFORE.

AS CONGRESS CONTINUES THE STRUGGLE TO CUT OUR FEDERAL DEFICIT, WE WILL JUSTIFABLY BE FOCUSING ON WHETHER TO RAISE TAXES OR CHANGE OUR RECENT PATTERNS OF SPENDING. HOWEVER, MR. CHAIRMAN, AS YOU ARE WELL AWARE THERE IS ANOTHER WAY TO MORE DIRECTLY ADDRESS AND REMEDY THE PROBLEM, AND THAT IS TO IMPROVE THE MANNER IN WHICH WE MANAGE THOSE RESOURCES ALREADY AT OUR DISPOSAL. IT IS FOR THAT REASON THAT CONGRESSMAN DIOGUARDI AND I HAVE INTRODUCED H. R. 4495, TO ESTABLISH THE OFFICE OF THE CHIEF FINANCIAL OFFICER OF THE UNITED STATES, WITHIN THE EXECUTIVE OFFICE OF THE PRESIDENT. TO

DIRECT AND COORDINATE FEDERAL FINANCIAL MANAGEMENT. H. R. 4495 ALSO ESTABLISHES AN OFFICE OF THE ASSISTANT SECRETARY FOR FINANCIAL MANAGEMENT WITHIN EACH EXECUTIVE DEPARTMENT, AS WELL AS AN OFFICE OF THE COMPTROLLER WITHIN EACH EXECUTIVE AGENCY. IT IS TOWARD THAT SECTION OF YOUR BILL THAT I WILL DIRECT MOST OF MY COMMENTS.

WE ARE ALL AWARE THAT OUR FEDERAL GOVERNMENT IS BIG ... A BUDGET THAT APPROXIMATES ONE TRILLION DOLLARS, 2,000 DIFFERENT FEDERAL PROGRAMS THAT ARE RUN BY MORE THAN 150 SEPARATE DEPARTMENTS, AGENCIES AND OFFICES, AT 25,000 LOCATIONS, AND ADMINISTERED BY TWO AND A HALF MILLION CIVILIAN WORKERS WHO OCCUPY SOME 400,000 BUILDINGS. THESE FACTS AND MORE WERE OUTLINED IN THE OFFICE OF MANAGEMENT AND BUDGET'S "REFORM '88" PROGRAM. AT THAT TIME OMB STATED, "WE DON'T REALLY KNOW THE TOTAL COST OF ADMINISTRATION, WHICH MEANS SIMPLY: WE DON'T KNOW THE COST OF DOING BUSINESS."

THE RAPID RATE OF GROWTH WE HAVE WITNESED IN THE FEDERAL GOVERNMENT HAS HAD AN IMPACT ON FINANCIAL MANAGEMENT AS WELL. THE OBJECTIVE OF FINANCIAL MANAGEMENT IN THE FEDERAL GOVERNMENT IS TO INSURE THAT, TO THE MAXIMUM EXTENT POSSIBLE, THE FINANCIAL RESOURCES AND THE THE REAL RESOURCES THEY REPRESENT ARE ACQUIRED AND USED LAWFULLY, EFFICIENTLY AND EFFECTIVELY TO ACHIEVE CONSTITUTIONALLY AND LEGALLY CONSISTANT PURPOSES. AS STATED IN _THE JOINT FINANCIAL MANAGEMENT IMPROVEMENT PROGRAM IN THE FEDERAL GOVERNMENT OF THE UNITED STATES_, PUBLISHED IN 1967, AND I QUOTE, "FINANCIAL MANAGEMENT IS THAT PART OF TOTAL MANAGEMENT WHICH IS CONCERNED PRIMARILY WITH FINANCIAL AFFAIRS OF AN ORGANIZATION AND THE

TRANSLATION OF ACTIONS, BOTH PAST AND PROPOSED, INTO MEANINGFUL AND RELEVANT INFORMATION FOR USE IN THE MANAGEMENT PROCESS. DEPENDING ON HOW AN AGENCY DECIDES TO SET UP ITS FINANCIAL ORGANIZATION, FINANCIAL MANAGEMENT MAY ENCOMPASS ALL OR PART OF SUCH SPECIFIC FUNCTIONS AS PROGRAMMING, BUDGETING, ACCOUNTING, REPORTING, CASH MANAGEMENT, CONTROL OF RESOURCES, COST REDUCTION, INTERNAL AUDITING, SYSTEMS DEVELOPMENT AND MANAGEMENT ANALYSIS." UNQUOTE. OBVIOUSLY, THIS IS NO SMALL TASK.

MR. CHAIRMAN, THE 1970's SAW SEVERAL MAJOR DEVELOPMENTS IN FINANCIAL MANAGEMENT. THE BUREAU OF THE BUDGET WAS REORGANIZED AND RENAMED THE OFFICE OF MANAGEMENT AND BUDGET IN ORDER TO EMPHASIZE A PLANNED AND INTENDED FOCUS ON MANAGEMENT. SINCE THEN THERE HAS BEEN A MINIMUM OF FIVE PIECES OF SPECIFIC LEGISLATION, AND NUMEROUS OTHER INTITIATIVES AIMED AT IMPROVING FINANCIAL MANAGEMENT. ONE OF THE MOST RECENT WAS THE GRACE COMMISSION'S REPORT ON "FEDERAL MANAGEMENT SYSTEMS". IT HIGHLIGHTED WHAT I THINK IS THE MOST CRITICAL PROBLEM IN TODAY'S FEDERAL FINANCIAL MANAGEMENT SYSTEM ... NO ONE AGENCY, DEPARTMENT OR PERSON, HAS BEEN GIVEN CLEAR-CUT AND ESTABLISHED AUTHORITY AND RESPONSIBILITY FOR DEVELOPING AND MANAGING THE FINANCIAL MANAGEMENT POLICY OF OUR COUNTRY. AS A RESULT, NO AGENCY, DEPARTMENT OR PERSON, HAS BEEN ABLE TO PROVIDE A CONTINUAL, RECOGNIZED AND CENTRALIZED EXAMPLE OF FINANCIAL MANAGEMENT AND FEDERAL LEADERSHIP.

THE NEED FOR A STRONG AND CENTRALIZED DIRECTION IN THE MANAGEMENT OF OUR NATION'S FINANCIAL RESOURCES BECOMES EVEN MORE EVIDENT WHEN ONE EXAMINES, AS I AM SURE YOU WILL DURING THESE HEARINGS, THE MEASURES, OR LACK OF MEASURES, CURRENTLY IN PRACTICE. FOR EXAMPLE, OMB, THE GENERAL ACCOUNTING OFFICE, THE GENERAL SERVICES ADMINISTRATION, THE OFFICE OF PERSONNEL MANAGEMENT, AND THE TREASURY DEPARTMENT, ARE ALL RESPONSIBLE FOR VARIOUS ASPECTS OF FINANCIAL MANAGEMENT. THIS DIVISION OF AUTHORITY AND RESPONSIBLITY CANNOT HELP BUT WEAKEN THE ACCOUNTABILITY AND CONTINUITY OF ANY INITIATIVES OR DIRECTIVES AIMED AT IMPROVEMENT.

LAST DECEMBER COMPTROLLER GENERAL BOWSHER ANNOUNCED THAT BILLIONS OF TAXPAYER DOLLARS ARE BEING LOST OR MISMANAGED THROUGH THE FAILURE OF MORE THAN HALF OF OUR GOVERNMENT'S 427 ACCOUNTING SYSTEMS TO MEET FEDERAL REQUIREMENTS. AND THERE IS ABSOLUTELY NOTHING NEW ABOUT THIS STATE OF AFFAIRS. UPON THE RELEASE OF HIS AGENCY'S STUDY, MR. BOWSHER SAID, "THE MAJOR PROBLEMS SO FAR REMAIN LARGELY UNCHANGED. WIDESPREAD AND OFTEN LONGSTANDING WEAKNESSES AND BREAKDOWNS IN AGENCY INTERNAL CONTROLS CONTINUE TO RESULT IN WASTEFUL SPENDING, POOR MANAGEMENT AND LOSSES INVOLVING BILLIONS OF DOLLARS." IN FACT, OF THE 427 ACCOUNTING SYSTEMS PRESENTLY USED BY OUR FEDERAL GOVERNMENT'S 18 AGENCIES, 226 WERE CITED BY THE GAO AS NOT COMPLYING WITH EVEN THEIR OWN AGENCY STANDARDS. THEY HAD BEEN IN USE FOR 35 YEARS! GAO ALSO DISPUTED CLAIMS BY 12 OF THE AGENCIES WHO HAD STATED THAT THEIR INTERNAL CONTROLS NOW PROVIDE A "REASONABLE ASSURANCE" FOR PROTECTING AGAINST WASTE AND FRAUD. SOME OF THE AGENCIES HAD NOT EVEN

EVALUATED THEIR INTERNAL CONTROLS.

FOR EXAMPLE, THE SMALL BUSINESS ADMINISTRATION REPORTED LAST YEAR THAT ITS ACCOUNTING SYSTEMS, "TAKEN AS A WHOLE", CONFORMED WITH GOVERNMENT REQUIREMENTS. YET THE AGENCY HAD NOT EVEN TESTED FIVE OF ITS EIGHT SYSTEMS, THROUGH WHICH 87% OF ITS ANNUAL $2 BIILION DOLLAR BUDGET WAS HANDLED. OTHER AGENCY ACCOUNTING AND INTERNAL CONTROL SYSTEMS ARE TECHNOLOGICALLY OUTDATED, RELATIVELY INFLEXIBLE AND OF ONLY MINIMAL ASSISTANCE TO MANAGEMENT IN THEIR OVERSIGHT AND MONITORING ROLES. KEY GOVERNMENT-WIDE FINANCIAL DATA IS NOT AS ACCESSIBLE TO BE SHARED WITH CONGRESS OR OTHER AGENCIES WITHOUT SPECIAL ANALYSIS AND MANUAL EFFORT. SOME DEPARTMENT'S ACCOUNTING AND MANAGEMENT INFORMATION SYSTEMS ARE NOT EVEN INTEGRATED OR COMPATIBLE WITH OTHER AUTOMATED PROCESSES OF THE SAME ORGANIZATION. SINCE FEW DEPARTMENTS AND AGENCIES HAVE COMPATIBLE BUDGETING AND ACCOUNTING SYSTEMS, FEW MANAGERS ARE ABLE TO EFFECTIVELY MANAGE OR EVEN PROVIDE ANY REAL ASSURANCES THAT CONGRESSIONAL APPROPRIATIONS ARE BEING EXPENDED AS PLANNED.

MR. CHAIRMAN, THESE ARE THE SAME AGENCIES THAT WE USE TO RUN OUR COUNTRY ... THEY ARE THE SAME BODIES OF OUR FEDERAL GOVERNMENT, UNDER OUR JURISDICTION AS MEMBERS OF CONGRESS, THAT ARE RESPONSIBLE FOR THE FINANCIAL AND OPERATIONAL AFFAIRS OF OUR NATION. YET THEIR REPORTING AND FINANCIAL MANAGEMENT SYSTEMS ARE INEFFECTIVE AND COSTLY TO THOSE WE SERVE, THE AMERICAN TAXPAYER. I THINK IT IS TIME THEY BE IMPROVED AND UPDATED TO REFLECT THE SCOPE OF TODAY'S FEDERAL GOVERNMENT.

MR. CHAIRMAN, LET ME SAY IN CLOSING THAT I BELIEVE S.2230, "THE FEDERAL MANAGEMENT REORGANIZATION AND COST CONTROL ACT OF 1986" WILL IN A VERY SIGNIFICANT AND NECESSARY WAY IMPROVE THE MANAGEMENT OF THIS NATION'S RESOURCES. JUDGING FROM THE SITUATION WHICH EXISTS, IT IS MY OPINION THAT LITTLE WILL BE ACCOMPLISHED THROUGH ADDITIONAL STUDIES, SPECIAL COMMISSIONS, EXECUTIVE ORDERS OR OMB CIRCULARS. ALTHOUGH MUCH HAS BEEN DONE TO ADDRESS THE PROBLEM, THERE IS STILL A GREAT DEAL OF ROOM FOR IMPROVEMENT ... ESPECIALLY IN THESE DAYS OF $200 BILLION DOLLAR DEFICITS AND TOTAL U. S. INDEBTEDNESS OF OVER $2 TRILLION DOLLARS.

AGAIN, I WANT TO THANK YOU CHAIRMAN ROTH, AND ALL OF THE MEMBERS OF YOUR DISTINGUISHED GOVERNMENT AFFAIRS COMMITTEE, FOR THE OPPORTUNITY TO APPEAR BEFORE YOU TODAY. I LOOK FORWARD TO WORKING WITH ALL OF YOU AS WE ATTEMPT TO MOVE TOWARD A SOLUTION TO THIS CHALLENGE.

THANK YOU.

Prepared Statement of Hon. Joseph J. DioGuardi

Mr. Chairman, I would like to commend you for taking the initiative in an effort to improve the management of the Federal government by both holding today's hearing and introducing the Federal Management Reorganization and Control Act. Your leadership in this area could well prove to be among the most significant items of the legislative legacy of the 99th Congress.

While I am just a Freshman Member of Congress, I have had a great deal of experience with matters of financial management as a partner with a Big Eight accounting firm. During my years with that firm I had the opportunity to work on one of the most extensive and exhaustive financial reviews of a governmental entity ever undertaken—that of New York City's finances in the mid 1970's. I believe the lessons learned from N.Y.C.'s financial crisis have a great deal of applicability to the Federal Government. For many years, the City of New York systematically shrouded economic reality in a cloak of accounting wizardry. We in the Federal Government are doing the same thing, and I fear will have to eventually pay the same penalty.

Because of my background, I intend to offer comments on only one part of the very broad legislation that you have offered. To the extent that I am an expert in anything, it is in financial management. While your legislation contains many areas that are of great interest to me, and of great potential benefit to the country, I will address my remarks to the Office of Financial Systems that your legislation would establish within the Office of Federal Management.

Let me begin my remarks by saying that the proposed Office of Financial Systems would be such a remarkable improvement over current law that its positive effects would be felt in government for years to come. Many in the private sector, in state government, and in the Federal Government have called for changes that are very similar to those you have proposed. I have introduced legislation in the House of Representatives, H.R. 4495, The Federal Financial Management Improvement Act, which, in a broad sense, calls for changes to be made in our financial management practices like those in your legislation, and I am favorably disposed towards your legislation for that reason.

One of the reasons that I pursued a career in Congress was that I believed that this country was mismanaging the financial affairs entrusted to the government. When I arrived in Congress, I was fortunate enough to secure a seat on the Government Operations Committee of the House of Representatives. After listening to testimony on that Committee from representatives of the various departments and agencies in the government, I became increasingly convinced of the need for reform of our financial affairs. My distinguished colleague from that body, Mr. Boulter, who has sponsored with me H.R. 4495, hit upon a stroke of genius that allowed me, as a Freshman, to begin working on this issue. Last year, he formed the bipartisan Grace Caucus in the House of Representatives. As a charter member of the Grace Caucus, and a member of its steering committee, I was given the opportunity of chairing the Financial Management Task Force of that Caucus.

Having agreed to lead that Task Force, I began to investigate those reforms proposed by the Grace Commission that involved financial management. There were literally hundreds of such suggestions. After careful review, I chose to pursue that suggestion which offered the most in potential savings and made the most sense to me as a person who had dealt with financial management matters. That was the suggestion that the United States establish a chief financial officer and invest in him sufficient powers so that he could reform the financial morass that plagues our government.

While the legislation that we are considering in this hearing today does not specifically establish a "chief financial officer", I believe that it does establish a position that has all the earmarkings of such. Specifically, it places in the Executive Office of the President a person of high rank to oversee all financial management decisions of the Federal Government; it gives that person the independence he or she would need to carry out meaningful reform by granting a term of office; and it centralizes the financial management practices of the Federal Government in one area.

I believe that each of these reforms is needed and I would like to share with the Committee my reasoning in this regard. First of all, after careful consideration of the various options for the placement of the CFO, I have come to the belief that placement of this officer in the Executive Office of the President is preferable to the options of placement within the Department of the Treasury, within the Office of Management and Budget or the establishment of an entirely independent agency. Within either Treasury or OMB, such an individual would not be preeminent because of the other, more pressing duties of those entities. If he was to run an independent agency, I believe his effectiveness would be greatly lessened because members of the Administration would have no real incentive to follow his advice.

The next item that I favor in the Roth bill is the establishment of a term of office for this individual. It is essential that this person be allowed to operate above the daily give and take of politics. A term of office is essential to that independence. In addition, reform of management practices is not a short-term task. We should allow the holders of this office the ability to succeed.

Finally, we should centralize the financial management practices of the Federal Government. Since I entered Congress I have constantly been admonished by my colleagues that we must be sure to recognize the differences between the private and public sectors. I have been told to turn in my green eyeshades. To that admonition I always respond that I will not turn them in for blinders. The private sector has long ago established the dictum that it is unwise to decentralize financial management practices and standards. They have done so because to do otherwise is to invite waste, fraud and inefficiency. I believe that it is long past the time that the Federal Government should follow suit. I think the legislation before the Committee admirably accomplishes that.

In conclusion, I believe that the proposals for financial management improvement embodied in this bill form the solid basis for a continuing effort. Their superiority to current law is immense. I commend the Chairman for his long leadership in this issue and look forward to working with him in the effort to make these long overdue reforms.

UNITED STATES GENERAL ACCOUNTING OFFICE
WASHINGTON, D.C. 20548

FOR RELEASE ON DELIVERY
EXPECTED AT 9:30 A.M.
TUESDAY, MAY 13, 1986

STATEMENT OF
CHARLES A. BOWSHER
COMPTROLLER GENERAL
OF THE
UNITED STATES
BEFORE THE
COMMITTEE ON GOVERNMENTAL AFFAIRS
UNITED STATES SENATE
ON
S.2230
THE FEDERAL MANAGEMENT REORGANIZATION
AND COST CONTROL ACT OF 1986

Mr. Chairman and Members of the Committee, I am pleased to appear today to testify on the "Federal Management Reorganization and Cost Control Act of 1986" (S.2230). This bill seeks to address significant management problems that have hampered the efficient and effective operation of government for many years. I share your concern that the management of government programs and operations must be greatly improved.

As the Congress and the President grapple with the budget deficit and make hard decisions on controlling government expenditures while maintaining essential programs and operations, it is vital that ongoing operations be as efficient as possible. This can only be accomplished if we have adequate management systems. Unfortunately, today, the government does not have top-notch management systems. Consequently, we lack the fundamental financial information needed to direct a trillion dollar operation and to restore taxpayer confidence in the government's ability to safeguard and manage its resources.

OFFICE OF FEDERAL MANAGEMENT

Your bill seeks to upgrade attention to management by establishing a separate Office of Federal Management. I share your concern over the relatively ineffective management improvement efforts of the past decade or more and understand your desire to move the "M" out of OMB to provide the necessary focus on management.

GAO studied centrally directed, government-wide management improvement programs conducted in the 1970's, and found that few initiatives had lasting impact. Similarly, a panel of experts at the National Academy of Public Administration concluded in a 1983 report, Revitalizing Federal Management, that the government had experienced a decade of declining managerial effectiveness despite efforts to solve specific management problems. They reported that improvement efforts have been sporadic, poorly planned, and inadequately backed and staffed. I see no evidence that this has changed.

The need for strengthened management systems has been further borne out in the general management reviews we have completed in four departments and agencies. These reviews have shown that the current approach to management in the federal government is not getting the job done. Several common themes have emerged:

1. the need for stronger leadership,
2. the need for better long range planning, and
3. the need for greater attention to developing adequate support systems such as financial and management information systems.

We plan further work in this area over the next several years. Improving government management is and will remain one of my highest priorities. A strategy for addressing the key management problems is essential to assure that changes in organizational structure and specific solutions for the problems are successfully implemented.

Let me make the point by using the financial management problem as an example. Problems in the government's financial management structure are serious and pervasive.

1. Financial information provided to Congress and the public concerning the condition and operations of the federal government is incomplete, inconsistent, unreliable, and untimely.
2. The accounting and other financial management systems used to manage and control government operations and to report the condition of the federal government are obsolete and inefficient.
3. Current financial reporting practices do not disclose the actual cost of operations:
    - they do not disclose the financial position of the government;
    - they do not disclose the current and probable future costs of investment decisions, such as the procurement of major weapons systems;
    - they do not permit effective comparison of actual costs and accomplishments to budget plans; and
    - they do not provide the timely information required for efficient management of programs.
4. The accuracy of financial information about the federal government is uncertain because most of the information is unaudited.

This situation hampers Congressional oversight and decisionmaking and adds significantly to the cost of government. Federal managers are also hindered as they strive to manage the operations of government more effectively.

GAO is not alone in recognizing these problems. Agency reports for the past 3 years under the Federal Managers' Financial Integrity Act cite serious and often long-standing problems with financial management and other management systems which have resulted in wasteful spending, poor management, and losses involving billions of dollars. In fact, all 18 departments and agencies whose reports we reviewed cited financial management as a major weakness.

It is particularly noteworthy in reading the Financial Integrity Act reports that about half of the government's accounting systems, covering almost 700 billion dollars in fiscal 1985, still do not conform to the Comptroller General's standards.

Debt collection continues to be a serious problem despite ongoing and past improvement efforts. Some agencies don't have reliable data on who owes the government money, how much they owe, and whether they can pay. We need to address debt collection and cash management much more aggressively than we have so far.

We need a broad strategy for dealing with these and other financial management problems. No one disputes that complete, consistent, reliable, and timely financial information about the operations and condition of the federal government is important for:

1. effective oversight of government programs;
2. effective and efficient management of government programs;
3. informed decisionmaking about budget priorities; and
4. public understanding and confidence in the performance of the government.

Most would agree that the financial information about the federal government which is needed by the Congress, the executive branch, and the public will require modern accounting and other financial management systems. But agreement on these broad generalities is not enough. We must also implement the systems to provide the specific types of information needed. For example, I feel strongly that audited agency-level financial statements are essential.

AGENCY FINANCIAL STATEMENTS

It is time for federal agencies to prepare annual financial statements so that the Congress and the public, not to mention the agencies themselves, have complete, accurate, and timely information on their financial position and results of operation. Since 1934, publicly-held corporations have been required by law to prepare annual financial statements which can sustain the scrutiny of an independent audit. In addition the Single Audit Act of 1984, passed under the leadership of this Committee, equires state and local governments receiving federal assistance to have comprehensive audits of their financial statements. The public deserves no less from the federal government.

Agency financial statements are crucial to instill discipline and coherence in financial management and accounting, to ensure data accuracy, and to provide a complete picture of the activities and accomplishments of federal agencies. The requirement for financial statements will provide a strong impetus for agencies to improve the financial management reporting systems needed by program officials to more effectively manage their programs.

Annual financial audits help assure the integrity and reliability of the statements and the underlying management systems. Evidence of this comes from the experiences of a number of state and local governments.

The problems of the Farm Credit System, which have been extensively reported, demonstrate what can happen when financial statements do not follow acceptable practices and financial audits are not performed to assure the reliability of data and reports. Unfortunately, the situation in many of our federal agencies is all too similar. I want to emphasize that I do not, nor does your bill as I read it, advocate the wholesale adoption of business-type financial statements for the federal government. Rather, we need to implement financial statements tailored specifically to the unique circumstances and requirements of the federal government's individual components.

OVERALL FINANCIAL MANAGEMENT REFORM NEEDED

The need for audited financial statements is but one item -- although a vitally important one -- in the broad blueprint for reshaping our financial management structure. Other important decisions must be made to ensure improvements are guided by a cohesive framework which lays out clear objectives. Such a framework can help to assure that there is continuity across successive administrations and that we are working toward a common set of long-term financial management goals.

To develop this framework we must make some tough choices, such as:

1. What types of information should be provided to compare program costs and accomplishments with the amounts and levels of activity planned in budgets?
2. What types of project reporting is needed to better manage major research, development, and construction projects?
3. What levels of detail should be available and who should have access to data from the financial management systems?

GAO has studied these issues and last year proposed a conceptual design in our report, Managing the Cost of Government, which I would like to submit for the record along with a joint study on federal reporting that we conducted with the Auditor General of Canada. These reports outline the need to develop a modern financial management structure guided by an overall plan that supports:

1. full disclosure of costs and financial commitments for all government activities;
2. strengthened accounting, auditing, and financial reporting, using consistently applied and comprehensive accounting principles and standards;
3. elimination of redundancy and duplication in financial processes and systems; and
4. better integration of planning, budgeting, and accounting.

Our reports were developed as catalysts to raise the issues and to begin movement toward consensus on an approach to improving federal management. There is agreement now that the issues are real and that we must begin to deal with them. Your bill is a serious attempt to do so. I know that others are concerned about some of its organizational features and details of the proposed solutions. While I share some of these concerns, nevertheless, the solutions to these problems are well within reach and I do not want to miss an opportunity to make real progress.

CONCLUSION

In conclusion, Mr. Chairman, we share this Committee's concern about the current poor state of federal management. We must improve our ability to effectively and efficiently direct government programs and operations. Your bill is an important step toward developing a strategy for making lasting improvements in our overall management and financial structure and we want to continue to work with you and your Committee in an effort to improve government management.

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This concludes my remarks. I would be happy to answer any questions.

Managing The Cost Of Government

Building An Effective Financial Management Structure

Comptroller General of the United States

Volume I Major Issues *GAO/AFMD-85-35*

February 1985 *United States General Accounting Office*

Preface

The situation lamented by Thomas Jefferson has worsened immeasurably. Federal finances are managed through an elaborate structure of decision processes and information systems. Many of these processes and systems, now obsolete, face ever-increasing difficulties in coping with the demands placed upon them.

The most visible evidence of difficulties is the enormous cost in time, energy, and public confidence involved in the annual search for consensus on the budget. Problems elsewhere in the structure are less visible but equally real:

- The processes by which we decide how much to spend, and for what purposes, are cumbersome, repetitive, and time-consuming.
- Controls over how federal money is spent are detailed and burdensome, but they are routinely found to be ineffective in preventing abuses.
- Budgeting, accounting, and management information systems often yield data that are unreliable, inconsistent, and all too often irrelevant.

The government must make a major effort to rebuild its financial management structure. Old computer systems must be replaced with more modern technology—a long, expensive process. At the same time, however, this updating creates the opportunity to build a structure that will serve the needs of government and the public in the last decade of the 20th century and beyond.

A modern structure for managing government finances will not cause the budget deficit to disappear, nor will it make difficult budget decisions easy. But it can ensure that congressional and executive branch officials receive timely, reliable, and consistent information with which to make those decisions.

This document and an accompanying, more detailed volume explain why we believe a major overhaul is needed; they discuss some of the most important elements of a new system. Many of these ideas have been suggested before. We now attempt to unite them in a single, comprehensive framework. This effort could not have succeeded without the generous assistance of a number of present and former government officials, as well as the accounting firms of Arthur Andersen & Co. and Coopers & Lybrand.

Building a more modern and effective financial management structure for the federal government is an ambitious goal, but it can be achieved if there is a broad consensus that the American taxpayer deserves no less.

Charles A. Bowsher
Comptroller General
of the United States

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Washington, D.C. 20402

Overview

The shortcomings of the present federal financial management system are numerous and well-documented. This report emphasizes five problem areas that demonstrate dramatically our need to overhaul the system:

Major Problems

Lack of Cost Information
Today's financial reports provide a flood of information. Yet there is little of the reliable cost data essential for effectively monitoring program execution, anticipating overruns, and providing a basis for future program and budget planning.

Lack of Reliable Information on Weapon Systems
Current project reporting systems are not tied to the accounting and budgeting systems. The reports, all too often, are incomplete, inconsistent and unreliable. Significant changes may be reported too late for remedial action to be taken.

Inadequate Disclosure of Costs and Liabilities
Major commitments of federal resources, such as retirement benefits, are only partially recognized in the budget. Other activities, such as the $106.9 billion loan portfolio of the Federal Financing Bank, are entirely excluded from the budget totals.

Unstructured Planning for Capital Investment
The federal government plays a major role in determining the level of investment for public capital facilities. Yet these vitally important decisions are made in an uncoordinated fashion, and the government's overall approach to capital budgeting provides capital expenditures little visibility in the budget process.

Antiquated Financial Management Systems
The federal government is the largest and most complex operating organization in the world. Its basic approach to financial management, however, is obsolete and inefficient. Many federal systems employ outdated equipment and are not designed to provide the information needed by managers, policy officials and Congress.

Previous efforts to remedy these and other problems have been piecemeal and partial. Successful reform requires a comprehensive, integrated approach. It should be government-wide in scope, serving the needs of both Congress and the executive branch, by ensuring that consistent data are available across agency and department lines. The effort should stress four key elements:

Four Key Elements of Reform

Strengthened Accounting, Auditing, and Reporting
Effective financial management must start with complete, reliable, consistent and timely information. Government financial systems must be designed to produce that information. Routine and special reports must be timely, useful and readily understandable, and the reliability of the information must be assured through effective auditing procedures.

Improved Planning and Programming
Many of the most pressing national issues cannot be adequately considered using a narrow, short-term focus. A modern financial management system should include a structured process for considering those issues, one that focuses attention on major issues, identifies alternative courses of action and analyzes their probable future consequences. The process must assure that the alternatives are

accurately and completely costed on the basis of data from the integrated accounting systems.

Streamlined Budget Process
To be effective, the federal budget process must be made more manageable, and integrated with the planning, programming and accounting phases of financial management. Reform is needed in both Congress and the executive branch. This effort should concentrate on eliminating unnecessary repetition, detail, and obstacles to action. The system and its operating procedures must be designed so that program managers, policy officials and Members of Congress can focus on the difficult budget choices that must be made.

Systematic Measurement of Performance
Effective management of resources requires examining the results of government activities as well as their costs. An integrated and disciplined financial management system that provides consistent data on cost and performance is essential to help both Congress and the executive branch assess the efficiency and effectiveness of government operations. Top appointive federal executives have relatively short tenures and are therefore especially dependent on reliable cost and performance reports to assure that resources are being used effectively.

Taken together, these elements form the conceptual foundation of a new financial management structure. Putting the new structure in place and making it work, however, will require much more:

Reform Will Require Investments in Systems, Organizations and People

System Development Efforts
New systems will have to be designed and installed, over a period of years, that consistently implement the concepts and take full advantage of the latest technology. Much of this effort can be accomplished with little additional cost by coordinating new and existing system development activities.

Organizational Changes
To operate the new structure efficiently, financial management responsibilities within the federal government may need adjustment.

Investments in People
To operate effectively, even the best-designed financial management system requires able, dedicated, well-trained people and continuity of leadership from skilled executives.

The potential benefits are substantial, but only if these efforts are part of a coordinated strategy of reform. This will require a sustained commitment over a number of years from both Congress and the executive branch. The basis for successful reform might best be established through a series of congressional hearings resulting in a bill or resolution setting forth the scope, objectives, leadership and timetable for the overall effort.

Cost Consciousness: Getting Full Value for the Taxpayers' Money

The federal government spends more than $2 billion a day on everything from social security benefits and the B-1 bomber to paper clips and pencils. The lack of good cost information has complicated the task of managing government efficiently.

Financial Reports Do Not Clearly Show the Costs of Government Activities

Controlling the cost of government requires knowing what government services and programs cost and why. But today's financial reports do not paint a clear picture of those costs. They focus instead on obligations (when an item is ordered) and on outlays (when the bill is paid). Both are important, but neither is a consistently reliable measure of the resources being consumed (costs) in carrying out government programs.

Obligation-basis reporting is essential in monitoring the extent to which agencies are making commitments for future payments. Cash-basis reporting is essential in managing fiscal, debt, and credit policies. Cost-basis reporting is essential in determining the cost of units of delivered service.

In some cases, the timing difference between obligations, outlays, and costs can be large and very important. For an agency that manages large, multi-year contracts or handles large inventories, a system that reports costs (as well as obligations and outlays) will reveal important information about the operations of the agency that is otherwise unavailable.

Budgeting and Accounting Should Both Be Done on a Cost Basis

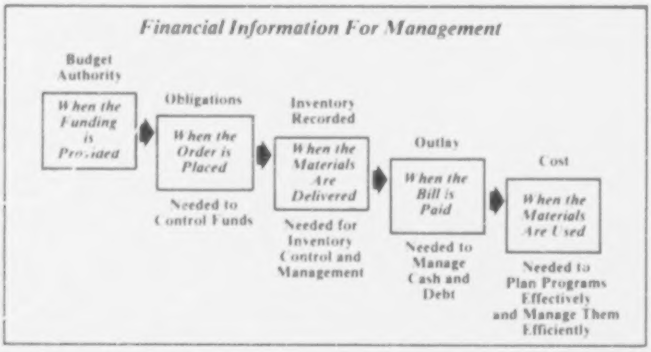
Budgeting and accounting should be done on the same basis, so that actual results can be measured against plans, but this is not now the case. Budgets are requested and justified in terms of programs and projects, such as infant health care or dams for flood control. Accounting and other financial reports, however, often focus on appropriations and categories of expenses such as travel or personnel, without relating them to the particular programs or projects for which the money was requested and approved.

Illustration Of A Typical Budgeting/Accounting Mismatch:

Budget System Reporting Categories	*Accounting System Reporting Categories*
• Maintenance and operation of facilities	• Personnel compensation
• Contract services	• Communications, utilities, rent and other
• Grants for state services	• Other services
• Civilian programs	• Supplies and materials

Costs Should Be Recorded and Reported Consistently Across the Government

Costs should be recorded and reported in a consistent manner across the government, but they currently are not. An integrated budget and accounting system that focused on costs could produce cost reports on such management responsibilities as operations (e.g., motor pools), organizations (e.g., the Public Health Service), programs or missions (e.g., child immunization), and projects (e.g., the Tellico Dam, the B-1 bomber). Such reports could compare the estimated and actual costs of operations, organizations, programs, and projects. Such a system could also make it possible to compare the costs of operating such activities as motor pools agency by agency, and to know the costs for the government as a whole.


Financial Information For Management
Budget Authority
When the Funding is Provided
Obligations
When the Order is Placed
Needed to Control Funds
Inventory Recorded
When the Materials Are Delivered
Needed for Inventory Control and Management
Outlay
When the Bill is Paid
Needed to Manage Cash and Debt
Cost
When the Materials Are Used
Needed to Plan Programs Effectively and Manage Them Efficiently

Integrated Cost-Based Budgeting and Accounting Has Already Been Implemented in Some State and Local Governments

Several state and local governments already have developed, to a far greater extent than the federal government, integrated budgeting and accounting systems that report costs. In some cases, the federal government has required this reform. New York City, for example, adopted an integrated budgeting and accounting system as a condition of federal assistance during the city's financial crisis of 1975.

Among the benefits to the federal government of adopting such a system would be:

Better Cost Information Permits Better Management of Government Activities

- The ability to compare planned with actual costs.
- Reliable project status reporting that focuses on costs, improving on the concept of the Defense Department's Selected Acquisition Reports for major weapon systems.
- If desired, the ability to establish user fees for government services that fully cover the cost of those services.
- The ability to compare costs of similar operations across the government.
- More accurate budget estimates based on actual past program and project costs.
- The ability to measure the input of cost and the output of performance.
- Greater assurance that financial transactions are not artificially moved from one fiscal year to another.
- Increased accountability for the management of public funds.

Consistent Information on the Cost of Major Weapon Systems

Good Financial Information on Major Weapon Systems Is Lacking

Although the Department of Defense is embarked on the largest peacetime program of weapons purchases in its history, it does not always provide complete and consistent information on the cost of these weapons. For example, the 64 major weapon systems included in the June 1983 Selected Acquisition Report (SAR) are estimated to cost almost $600 billion. This figure does not include the cost of people, spare parts, and other support equipment necessary to operate and maintain the weapons.

Several recent examples demonstrate what happens when there is a lack of consistent and complete budget and accounting information to support both budget estimates and program management.

On the F/A-18 fighter plane, the Navy used budgetary practices that obscured from Congress a $310 million cost increase. Funds provided for support equipment were used to pay for the plane itself. The Navy then asked Congress again for the money for the support equipment. In effect, the Navy budgeted the same support equipment twice. Good project reports on planned versus actual costs and accomplishments would have revealed the overrun much earlier.

Inconsistencies in the December 1982 Selected Acquisition Report (SAR)

The December 1982 SARs illustrate some of the problems in current project reporting for major weapon systems:

- The $20.1 billion baseline SAR estimate for the B-1 bomber excludes more than $1 billion in costs, such as flight simulators for pilot training, that are normally included in SAR program estimates for aircraft.
- The estimate for the Army's Bradley Fighting Vehicle showed a decrease of $679 million in ammunition cost. This cost was subtracted because SARs do not include ammunition costs unless the ammunition is unique to a specific weapon system, and the Army had decided to buy the same ammunition for the Bradley and the Light Infantry Vehicle.
- Though they are built by the same contractor, two different inflation estimates were used for the Navy's Tomahawk Missile and the Air Force's Ground Launched Cruise Missile. Since the December SARs must tie to the President's budget, the budget requests for these two systems were not based on consistent information.

Current SAR Project Reports on the Costs of Major Weapon Systems Are Not:

- **Tied to the accounting systems,**
- **Consistent from year to year,**
- **Consistent with other budget and accounting reports**

The SARs are provided to Congress quarterly. They were first issued by the Defense Department in 1969 because its management systems, which focused on obligations, did not provide needed information on costs, production rates, and technical performance.

Though useful, the SARs have three major limitations. First, the SARs rely on contractor and other information that does not necessarily tie to the accounting systems of the Department of Defense and can be reconciled to the budget only in December. The experience of the Atomic Energy Commission (AEC) shows that this need not be the case. In cooperation with its contractors, the AEC developed contractor project reports that tied directly into the AEC's own accounting and budgeting system. These reports could then be used to monitor contractor performance and prepare consolidated statements on AEC programs to support future budget requests.

Second, information on the same weapon systems may be reported differently from one year to the next, and the changes are not always clearly explained. The SAR of December 31, 1982, for example, reported the Trident II submarine as a new weapon system even though the only difference between it and the Trident I was the type of missile it would carry. This had the effect of disrupting the historical data on what is essentially the same weapon system.

Finally, the information in the SARs is not consistent with that in other budget documents provided to Congress. According to the Congressional Budget Office, cost estimates in the December 31, 1982, SAR for 13 systems excluded at least $40.8 billion in program costs reported elsewhere.

Continued dissatisfaction with the SARs led to the 1981 passage of the Nunn Amendment, which is designed to provide earlier notification of cost increases, in time to take remedial action.

Clear, Summary Project Reports Can Provide the Information Top Decisionmakers Need

Clear, summary project reports of the type displayed below would make it much easier for Members of Congress and executive branch officials to quickly determine the status of projects—civilian or military—and explore further the causes of any increased cost estimates and schedule slippages. They would have the information they need to see a project's expected cost, how this compares to previous estimates, how much money has been spent, and what it has been used for.

A Sample Project Report
Construction Of A Strategic Missile Submarine

Project Status As of 10/3/83

Phases	*Planned Cost*	*Actual Cost To Date*	*Estimate to Complete*	*Total Cost to Complete*	*Increase (+) Decrease (–) From Plan*	*Months Under (–) Over (+)*
Research and Development	16	20	0	20	+4	+2
Testing and Evaluation	4	3	0	3	–1	
Design	10	11	0	11	+1	+1
Procurement	70	10	65	75	+5	+2
	100	44	65	109	+9	

Funding Status As of 10/3/83

Appropriation				*Obligations*	
Number	*Description*	*Date*	*Amount*	*Amount*	*Unobligated*
XXXX	*Research and Development Testing and Evaluation (FY 82)*	10/81	20	20	0
XXXX	*Research and Development Testing and Evaluation (FY 82 Supplemental)*	2/82	3	3	0
XXXX	*Shipbuilding and Conversion (FY 83)*	10/82	10	10	0
XXXX	*Shipbuilding and Conversion (FY 83 Supplemental)*	4/83	1	1	0
XXXX	*Shipbuilding and Conversion (FY 84)*	10/83	70	35	35
	Totals		104	69	35
	Current Estimate		109		
	Increase (+) Decrease (–)		+5		

Full Disclosure of Costs and Liabilities

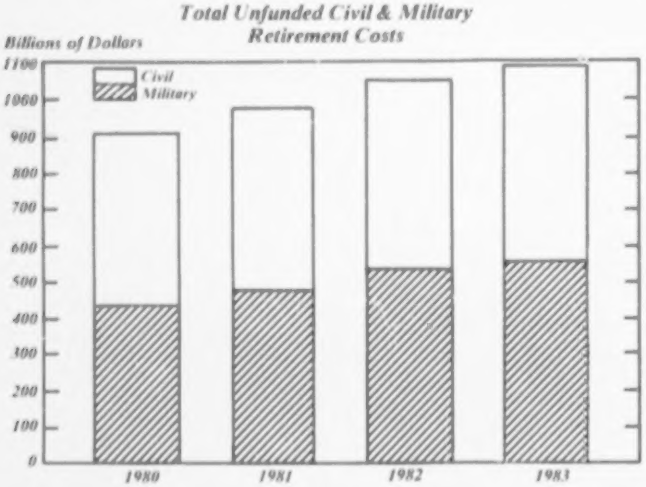
Federal Costs and Liabilities Are Not Fully Disclosed in the Budget

Today, the federal budget does not include all government activities, nor does it disclose all costs of those activities that do appear in the budget. In addition, financial reports do not fully disclose the government's financial commitments. These gaps make informed policy choices much more difficult.

The government's liability for retirement benefits represents a major commitment of future federal resources. A recent report estimated the unfunded portion of retirement benefits to be several hundred billion dollars. But the budget only partially recognizes retirement benefits being earned by today's civilian employees, while those of military personnel were not recognized at all until Congress recently changed the law.

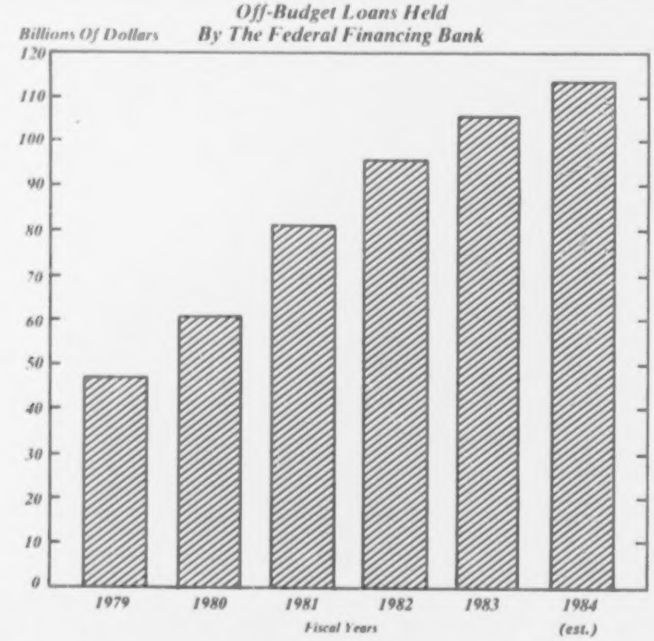
Unfunded Retirement Liabilities Mortgage the Future

The costs and liabilities of retirement programs increase as a growing number of federal employees earn and receive retirement benefits. At the end of fiscal year 1983, for example, there were more retired (319,000) than active duty (300,000) military officers on the Defense Department payroll. To avoid the risk of inappropriately mortgaging the future, decisionmakers should recognize the long-term consequences of current benefits and any proposed changes to them.


Total Unfunded Civil & Military Retirement Costs

Off-Budget Spending Undermines the Budget Process

Resource allocation decisions become more difficult when the budget does not fully recognize all of the government's activities. Among these is the Federal Financing Bank, which has $106.9 billion in off-budget loans outstanding and issued some $32 billion in new loans in fiscal year 1982. But the Federal Financing Bank is small in comparison to the Social Security retirement and disability funds. The new Social Security law recently passed by Congress will move these funds off-budget, beginning in 1993, dramatically reducing the comprehensiveness of the budget even further.



Inadequate Disclosure of Credit Program Costs Can Mislead Decisionmakers

Costs of direct loans, such as loan write-offs and interest subsidies, are not routinely disclosed to decisionmakers. Anticipated write-offs, such as those for foreign military sales and many loan programs, are often not recognized in the budget or the accounting systems. The cost of interest subsidies is often buried as part of the interest on the public debt. Thus, decisionmakers may be misled into assuming that programs are less expensive than they are.

Loan guarantees are another case where the government's financial condition is not fully disclosed. Contingent liabilities should be accurately measured and incorporated into the government's financial reports.

Budget documents, financial statements, and reports received by Congress and the executive branch should fully disclose the financial position of the government, and reflect all costs of government activities.

Better Planning for Capital Investment Decisionmaking

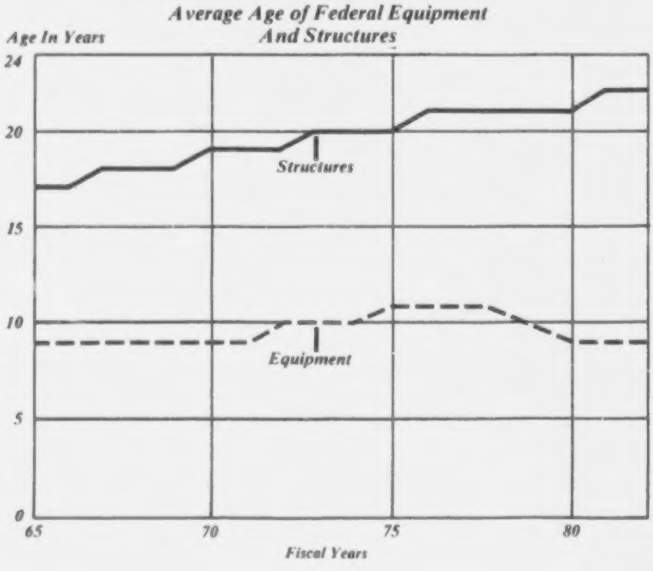
Capital Investment:

- **Is widely dispersed,**
- **Has little visibility,**
- **Is not distinguished from current operations**

The federal government is a major participant in developing and maintaining a wide array of public capital facilities. When it owns the facility, the federal government's involvement is direct. In other cases, the government is a source of financing for facilities owned by others. In recent years, as public concern about the deteriorating condition of many types of public facilities has grown, federal systems for planning, budgeting, and financing of capital assets have been criticized and debated by leaders of business and government alike.

Federal capital investment activity is managed through numerous agencies, programs, and funding sources. There is no structured approach to making capital investment decisions and no policy mechanism for assessing capital investment priorities for the government as a whole. The lack of visibility for investment decisions, coupled with a budget and accounting approach which treats capital spending as if it were the same as spending for current operations, creates what some consider to be a systematic bias against capital investment. The Congress has recognized the need for greater visibility for capital investment, and took a first step in that direction with passage of the Federal Capital Investment Program Information Act of 1984.

Business organizations and most state and local governments budget separately for operating and capital investment spending. The federal government's budget, however, should be as comprehensive as possible, reflecting the importance of the budget totals for economic policy purposes and the need to consider the full scope of government activities in the budget process.


Average Age of Federal Equipment And Structures

Increased Visibility Would Aid in Making Capital Investment Decisions

The needed visibility of capital budgeting within the unified budget could be achieved by displaying capital investment activities separately. Thus, each major functional category in the budget (e.g., national defense, energy, agriculture) would include an operating component and a capital investment component.

The capital component would include new investments in capital assets, whether acquired directly by the federal government or through loans and grants to state and local governments. The several capital components could be combined to represent the federal government's capital budget.

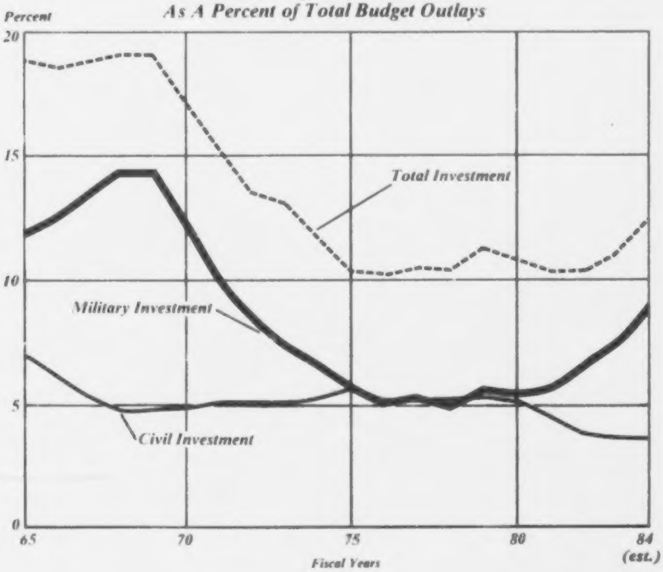
The operating component would include salaries, utilities, contracted services, and other expenses not related to investment, as well as depreciation expenses if applicable.

Federal Capital Investments Should Be Displayed Separately Within the Unified Budget

This separation of capital and operating expenditures within the unified budget would

- elevate the visibility of capital investment decisions,
- facilitate the development of replacement planning, and
- allow a comparison of the long-term costs and benefits of capital investments across budget functions.

Federal Capital Investment
As A Percent of Total Budget Outlays



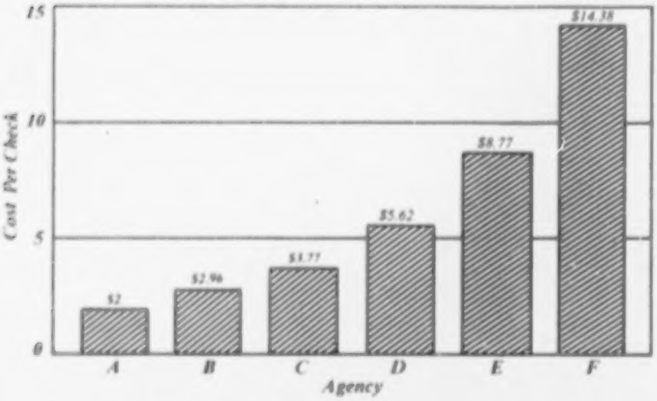
Streamlining and Modernizing Financial Management Systems

Many Federal Financial Management Systems Are Old, Inefficient and Inadequate

Federal decisionmakers are working with financial management systems that were designed for a bygone era. These often antiquated systems are characterized by gaps, inconsistencies, inefficiencies, and wide disparities in quality. According to a recent presidential study commission, much of the government's data processing technology is out-of-date, and senior officials of the government have no practical means of collecting summarized management information on a government-wide basis.

Current financial management systems are inefficient. The average cost to issue a federal payroll check currently varies from about $2 to $14 depending on what payroll system is used.

The Cost Of Processing Federal Payroll Checks Varies Widely



Efforts to Update these Systems Have Been Only Partially Successful

Agency efforts to update obsolete equipment for their financial management systems often do not take full advantage of improved technology. Frequently, agencies acquire new hardware without redesigning their systems to fully exploit the new equipment.

Some agencies (such as the Air Force, the Department of Agriculture, the Department of Commerce, and the Veterans Administration) have tried to modernize and consolidate their systems. But accomplishments are limited by the need to interact with antiquated systems elsewhere. For example, Veterans Administration payment tapes are flown from Illinois to Austin, Texas, and hand-delivered to Treasury where checks are prepared.

For years, GAO has been pointing to the need for modern financial management systems, but limited progress has been made. Building such systems will require long-term commitment of leadership and resources, and a coordinated approach using a common conceptual framework.

Building New Systems Will Require a Coordinated Approach and Long-Term Commitment

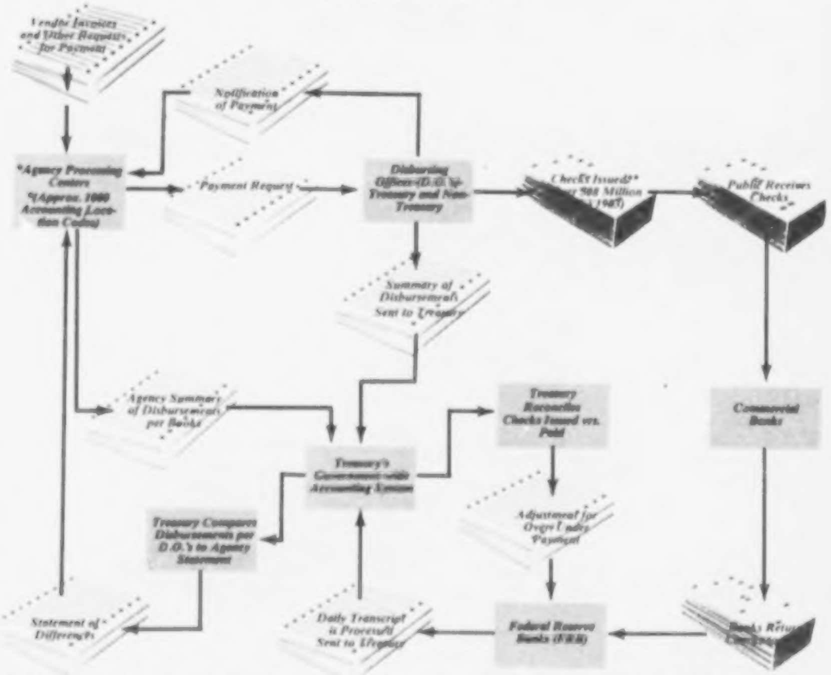
There are two basic approaches to improving current systems. One is to redesign existing systems without altering the basic roles and missions of agencies involved in federal financial management. This approach will yield new systems and equipment. But it will not achieve the most efficient operations.

A second approach might be to revise the basic structure of financial management by locating a few (e.g., 20 or so) processing centers in the cabinet departments and major agencies to handle both disbursements and financial accounting. Other federal agencies could share common systems for related activities, allowing substantial savings in development and operating costs. The result would be higher productivity in federal financial management operations and more timely, compatible, and reliable financial information.

A Modern Approach Would Yield Consistent and Reliable Summary Information for Decisionmakers

Consistent, comparable information from the individual agency systems should flow into a central system that is capable of routinely summarizing, consolidating, and reporting relevant information to top policymakers in the executive branch, Members of Congress, and the public on a timely basis.

Current Disbursement Process Paper Flow
For Check Payments


Vendor Invoices and Other Requests for Payment
Notification of Payment
*Agency Processing Centers
*(Approx. 1000 Accounting Location Codes)
Payment Request
Disbursing Offices (D.O.'s) Treasury and Non-Treasury
Checks Issued** Over 500 Million (FY 1985)
Public Receives Checks
Summary of Disbursements Sent to Treasury
Agency Summary of Disbursements per Books
Treasury's Governmentwide Accounting System
Treasury Reconciles Checks Issued vs. Paid
Commercial Banks
Treasury Compares Disbursements per D.O.'s to Agency Statement
Adjustment for Over/Under Payment
Statement of Differences
Daily Transcript is Processed Sent to Treasury
Federal Reserve Banks (FRB)
Banks Return Checks

** This does not include approximately 150 million checks issued by other agencies. In addition to checks, Treasury made over 197 million payments through electronic funds transfer.

Strengthened Accounting, Auditing, and Reporting

Good Management Depends on Good Information

Effective management of the Nation's financial resources rests on a foundation of financial information derived, for the most part, from budgeting and accounting systems. The importance of good financial information underscores the need for well-designed integrated budgeting and accounting systems. Because current systems are not integrated, budgets are frequently developed without reliable information on what has occurred. This often leads to unrealistic budget planning and difficulty in controlling budget execution.

Reforms are needed to strengthen how the government accounts for financial resources and to improve the financial information used by Congress and the executive branch. The consistent application of comprehensive accounting principles and standards by all agencies would ensure comparability of financial data throughout the government. Then, financial data would reflect differences in fact, rather than differences in the accounting treatment of the same facts.

Improved Accounting Systems Can Provide Essential Information

Because federal accounting systems need to communicate more useful information to decisionmakers, they should encompass certain basic features:

- Costs and revenues should be displayed along several relevant dimensions, e.g., appropriation, organizational unit, program, and project.
- The obligation of funds, payment of bills, and the use of goods and services (costs) should all be recorded and reported.
- Performance information should be routinely integrated with accounting systems to help in assessing effectiveness and efficiency.

Consolidated Financial Statements Are an Additional Source of Information

Consistent, comparable data from integrated financial systems is essential for preparing government-wide financial statements. These statements can supplement other budgeting and accounting information by giving an overall picture of the financial health of the government that is not available elsewhere. They could also disclose the cumulative financial effect of decisions on the Nation's resources and provide early warning signals to policymakers.

Many organizations, such as publicly owned corporations, are required to present comprehensive financial reports to the public. Just as shareholders expect management to report the financial position of their companies, so taxpayers should hear about the financial position of their government. Many state and local governments are moving toward this practice, partially influenced by federal reporting requirements for Revenue Sharing and other programs.

The federal government is a unique entity, and its financial statements must adequately reflect that fact. Though requiring further development, the "prototype" financial reports prepared by the Treasury are a useful first step toward this goal.

With the installation of modern integrated systems, and the adoption of comprehensive accounting principles and standards, agencies can efficiently provide the information for consolidated federal financial statements that can be annually audited.

Financial Reports Should Be Audited Annually to:

- **Increase discipline,**
- **Enhance oversight,**
- **Help assure financial integrity**

Auditing introduces discipline to the financial reporting process by confirming the accuracy and reliability of the information in financial statements. Financial auditing also enhances the oversight of programs, by providing a better basis for selecting areas for program audit and evaluation. Leadership in auditing federal financial statements rests with GAO, working with the Inspectors General, but the effort may well also require the involvement of independent public accountants.

Auditing is also essential to any program to strengthen internal controls. The Federal Manager's Financial Integrity Act of 1982 represents important progress. This act requires each executive agency to report annually on its compliance with internal control standards prescribed by the Comptroller General, and its plans for correcting any problems.

Consolidated
Financial
Statements
of the United States Government
AUDITOR GENERAL
State of Maryland
INDIANAPOLIS
NEW YORK
COMPTROLLER

Improved Federal Planning and Programming

Improved Decisionmaking on Major Policy Issues Requires:

- **Better information on past performance,**
- **Systematic consideration of alternatives, and**
- **Careful analysis of their long-term consequences**

Sound financial management requires a process that focuses attention on major policy issues and alternatives and their probable future consequences. To be effective, the process needs information on the actual costs and benefits of prior decisions.

The federal government currently has few of the necessary pieces of such a process. Often, top management attention to policy or legislative issues is unstructured, divorced from actual experience, focused on individual programs, and concerned only with the next year or two.

But, increasingly, the major problems facing the Nation defy short-term, narrowly focused solutions. With rising health care costs and an aging population, for example, managing the costs of Medicare requires both a long-term strategy and consideration of the interaction of Medicare with other health programs such as Medicaid, and with private health insurance programs.

A Structured Planning and Programming Process Would Meet This Need

A structured planning and programming process can help identify solutions to major long term problems such as financing health care. The cornerstone of this concept is the use of a formal, analytic process for considering the medium and long-term implications of current decisions. Efforts to develop a good planning and programming process for the government as a whole should build on the concepts developed over 20 years of experience with the Defense Department's Planning, Programming, and Budgeting System (PPBS).

Planning and Programming Should Be Integrated With Financial Management

Planning/programming, budgeting, and accounting are separate, but interdependent, phases of the financial management process. To be successful, a planning and programming structure must be an integral part of financial management decisionmaking, as it is in the Defense Department. When PPBS was tried by civilian agencies in the late 1960s, it failed in part because it was added to, and often competed with, existing systems and processes, rather than being built into

Effective Planning And Programming

Major Elements	*Major Benefits*
• A Mechanism to identify, evaluate, and select realistic goals and strategies for addressing major issues.	• Assist officials to focus on the fundamental questions of what the government should be doing and how best to accomplish it.
• A multi-year view for those programs where sound choices cannot be made using the one-year budget horizon.	• Encourage longer term thinking and permit more realistic multi-year financial planning for agencies and the government as a whole.
• A program structure that relates the costs of programs to the out-puts (results, benefits) produced or missions served.	• Provide an essential analytic framework for decisionmaking and a better basis for evaluating the benefits and costs of alternatives.
• The ability to apply modern analytic techniques in assessing issues and alternatives.	• Facilitate choices among alternative goals, missions, strategies, and programs.
• A means to aggregate program costs by major activity area and agency as well as government-wide.	• Help assure that programs are affordable and balanced given national priorities.
• Feedback mechanisms that reliably, consistently, and systematically develop and provide useful program performance information and analyses to those who need it.	• Enable officials to learn about the results of past decisions and apply this knowledge more effectively when future program decisions are made.

the basic structure of financial management. Budgeting, as the most formal, visible and independent financial management process, continued to dominate financial management decisionmaking.

Budgeting Often Fails to Make Good Use of Planning and Accounting Information

Today, in much of the government, budgeting remains the dominant financial management process and the focus of decisionmakers' attention. The budget process tends to operate as a separate system that ignores or "crowds out" information from both agency planning and program offices and the accounting system. Consequently, products developed in these two phases are not used well in the budgetary process. Yet sound budgeting and sound financial management depend both on the analysis of future trends and program needs (planning/programming) and on past performance (accounting). No single process should dominate.

An effective planning and programming process must of course be designed to meet the particular needs of each agency and program area. But the six major elements shown in the accompanying chart should always be present.

While originally developed for use in defense, structured planning and programming is useful in any area involving complex issues with multi-year implications. Housing policy, for example, involves complex interactions among diverse programs and the decisions entail major commitments of resources over many years.

Better Planning and Programming Would Reduce Some of the Pressures on the Budget Process

A well-developed, modern, government-wide structure of planning and programming would highlight the major policy and program options available to decisionmakers together with their likely benefits and costs. Making these decisions in a more systematic way would reduce some of the pressure on the budget process. It would also enable Congress, the President, and agency officials to focus their policy deliberations more systematically on the major issues facing the Nation.

Conceptual Relationship Of Planning, Programming And Budgeting

Phase	*Planning*	*Programming*	*Budgeting*
Executive Branch Activities	*Set Policy Objectives And Priorities Within Fiscal Limits*	*Develop Multi-Year Programs To Achieve Objectives; Reassess Priorities*	*Prepare Detailed Budget Estimates For Next Fiscal Period*
Legislative Branch Activities	*Enact Basic Tax Structure* *Enact Programs And Authorizations* *Enact Budget Resolutions*		*Enact Periodic Appropriations And Reconciliation Bills*

Spotlighting National Policy Choices: Strengthening and Streamlining the Federal Budget Process

The Current Budget Process Is Unduly Detailed, Repetitive, and Work-Intensive

Reliable, timely information is indispensable to an effective budget process, and we have highlighted some ways of improving that information. But equally important is a budget process that focuses the attention of decisionmakers on the available choices. The current budget processes of Congress and the executive branch are unduly detailed, repetitive, and work-intensive. These processes urgently need to be simplified and streamlined so that decisionmakers can more easily concentrate on the budget choices that confront them.

Past Budget Process Reforms Have Added to the Workload

Over the years, both Congress and the executive branch have made changes designed to improve their budget processes. The Congressional Budget and Impoundment Control Act of 1974 created an essential framework for Congress to set national priorities. But the act did this by adding to the existing machinery for authorization, appropriation, and tax legislation. Though it devotes an ever-greater proportion of its time to budget issues and the budget process, Congress in recent years has been unable to pass a budget and enact all appropriations laws before the beginning of the fiscal year.

Improvements tried in the executive branch—e.g., planning, programming, and budgeting (PPB); management by objective (MBO); zero-base budgeting (ZBB)—have also generally been added to existing systems and processes. As a result, both Congress and the executive branch are faced with burdensome processes marked by repetitious detail that obscures, rather than highlights, budget choices.

Budget execution, like budget preparation, has grown more detailed and complex. Managerial flexibility and efficiency is increasingly limited by the growing number of constraints on the uses of funds imposed by both Congress and executive branch officials.

Key Events In Executive Branch Budget Process

	March (or Earlier)	April/ May	June	July- Sept. 30	Oct./ Nov.	Dec/Jan.
	Budget Policy Development		Preparation And Submission Of Agency Budgets To OMB		OMB & Presidential Review Decisions	Budget Prepared And Submitted To Congress
Agencies/ Departments	Reviews Major Programs & Budget Issues	Submits Projection of Future Needs to OMB	Issue Internal Budget Guidance	Prepare & Submit Budget To OMB For Review	Defend Budget To OMB. Revise To Meet President's Decisions	Final Agency Appeals To President
Office Of Management And Budget (OMB)	Develops Economic Assumptions, Fiscal Projections	Issues Policy Guidance Economic Assumptions	Issues Budget Planning, Targets to Agencies	Economic, Fiscal Assumptions Updated	Reviews Agency Budgets, Advises President, Reexamines Economic, Fiscal Assumptions	Final Review Of Economic, Fiscal Assumptions Budget Prepared For Congress
President	Discusses Budget Outlook/Policy With OMB & Others		Establishes Overall Budget Policy And Targets		Decides Agency Budgets, And Final Economic Fiscal Assumptions	Decides Final Appeal Revises And Approves Budget

During this same time supplemental budget requests for the current budget year are prepared and sent to Congress and the current year's budget is being executed.

Recent Studies Suggest Simplifying the Federal Budget Process

There is growing recognition that the federal budget process must be simplified. Proposals for improving the congressional budget process have come from both within Congress and such outside groups as the Committee for Economic Development. They include selected changes in congressional organization and procedures; a biennial budget for part or all of the federal government; and the adoption of a single, omnibus budget, appropriations and tax bill. All these proposals have the common goal of reducing the number of layers in the congressional budget process and/or reducing the number of budget decisions that Congress must make each year.

Similar issues have been raised about the executive branch process as indicated by a recent report of the National Academy of Public Administration and continuing reform efforts within the Office of Management and Budget.

A Streamlined Budget Process Will Allow Decisionmakers to Focus More on Other Important Responsibilities

Proposals for reform in both Congress and the executive branch should be judged against the overriding objective of making the process more manageable and understandable. Members of Congress and top executive branch officials must be less encumbered with unnecessary detail so they can give more attention to major policy issues, the long-term consequences of current budgetary decisions, and the oversight and management of government programs and agencies.

Key Events In Legislative Branch Budget Process

	Jan. - Feb.	*May 15*				*Sept. 15*	*Sept 25*	*Oct. 1*	
Legislative Activity	*President's Budget Submitted*	*First Budget Resolution Adopted*		*(Debt Ceiling Raised)**		*Second Budget Resolution Adopted***	*Reconciliation Bill Enacted*	*New Fiscal Year Begins*	*(Possible Continuing Resolution Enacted)**
Budget Committees	*Hearings & Report First Budget Resolution*			*Work on Second Budget Resolution*					
Authorizing Committees	*Hearing, Views & Estimates Reports on Budget, Report Authorization Bills*		*Authorization Bills Enacted*				*Reconciliation*		
Appropriation Committees	*Hearings, Views & Estimates Reports on Budget, Work on Appropriation Bills*				*Appropriations Bills Enacted*				
Tax Committees	*Hearings, Views & Estimates Reports on Budget, Work on Possible Revenue Bills*				*Revenue Bills Enacted*		*Reconciliation*		
Congress		*Debate And Floor Votes*	*Debate And Floor Votes*	*Debate And Floor Votes*	*(Debate And Floor Votes)*	*Debate And Floor Votes*	*Debate And Floor Votes*		*Debate And Floor Votes*

**If necessary*

***In recent years, reconciliation has occurred after the adoption of the first budget resolution.*

Strengthening the Ability to Monitor and Evaluate Performance

It is Important, and Possible, to Measure How Well Government Employees and Programs Are Performing

Whether the goal is defending the nation or immunizing children against disease, government officials and the public need to know how well government is accomplishing its intended objectives. Assessing government accomplishments requires measuring employee and program performance. Though the size and complexity of the government make it difficult, developing effective performance measurement systems is clearly possible.

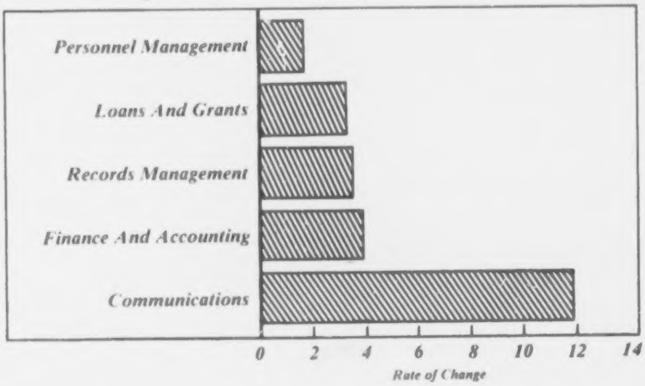
The work of nearly two-thirds of government employees, for example, can be measured by means of formal productivity measurement systems. For the remaining one-third, substantial time and effort may be required to develop reliable measures of performance. Indeed, there may be some government activities (such as basic research) for which quantitative measures are not feasible. Even in these cases, however, qualitative measures can usually be developed and used.

Effective Performance Measurement Systems Should Be an Integral Part of Financial Management

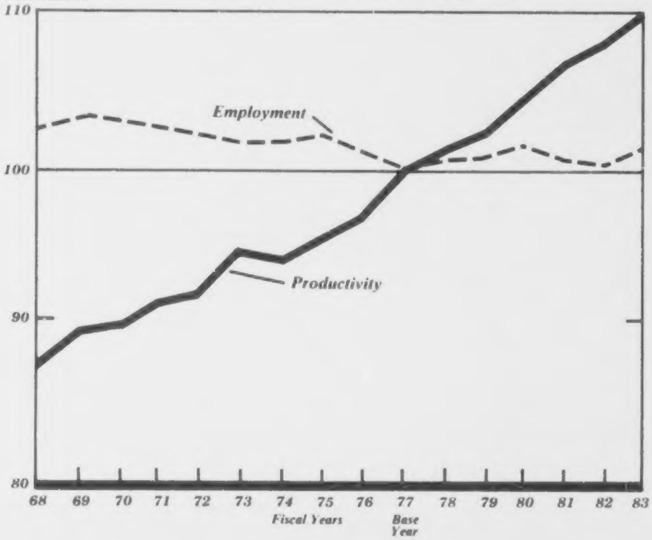
A well-developed financial management structure should include performance information that can be used for both day-to-day management and policy and budgeting decisions. An effective system of measuring program performance requires

- agreeing on objectives and relevant measures of accomplishment;
- systematically collecting reliable, consistent, and comparable information on costs and accomplishments;
- supplying that information routinely for use in management, planning, programming, and budgeting.

Average Annual Rate Of Change In Productivity By Selected Activities - 1967-1982



Measured Productivity Trends For The Federal Government FY 1968-1983



Performance Data Can Answer Many Routine Questions of Decisionmakers

Strong performance monitoring systems can answer many routine questions about program performance. Consider, for instance, a program whose goal is to immunize children against certain childhood diseases (e.g., mumps, polio). A system of performance indicators would provide information on the level of resources and effort devoted to each program site, the number of eligible children being served, the number of immunizations administered, and the cost per immunization. The incidence of these diseases in children could also be monitored.

However, Special Studies Are Also Needed to Provide Important Additional Information for Decisionmaking

Even the best monitoring systems, however, cannot answer many important questions about program effects and policy alternatives. Carefully designed studies to determine the actual accomplishments of a program and to examine other complex issues are an essential part of a modern management structure. In our example, we may notice that there is an unexplained drop in immunizations and therefore need to undertake a special study to explore the reasons. A modern structure of financial management should include a systematic way to identify questions warranting special analysis of this type.

Such special studies can provide decisionmakers with important additional information about program performance. But it is equally important that these studies be designed so that their results can be integrated with the information produced by the regular performance and financial reports. The results can then be used to help identify both future resource and program needs, and ways of improving the routine performance measures in use.

Putting In Place A Modern Structure Of Financial Management

There is a growing recognition that federal financial management needs to be modernized. Many efforts are now underway to improve financial management systems and reporting, including projects in the Departments of State, Treasury, and Commerce, as well as the government-wide initiatives of "Reform '88." Congress is considering several proposals for reform as well. The challenge is to integrate these efforts into the broader strategy outlined in this report. This can lead to the creation of a more modern, efficient, responsive, and reliable financial management structure to support decisionmaking and management in both Congress and the executive branch.

Building a Modern Structure of Financial Management Will Require:

- **Investments in systems and people,**
- **Organizational changes,**
- **Coordinated commitment, and**
- **Consensus**

This report highlights the benefits that could be achieved through a modern structure of financial management. Many of them already exist in the integrated financial management systems of progressive state and local governments. We are convinced that such a structure can be built for the federal government, but it will not emerge by accident, nor can it be created through isolated efforts in a few agencies. Building the structure will require the design and installation of new systems over an extended period. Coordination of new and existing system development activities can yield major benefits at little additional cost. An equally important investment must be made in the people who implement and operate the systems. They must be recruited more carefully, trained more thoroughly, and offered a more attractive career path.

In addition, organizational realignments will be needed. Financial operations should be consolidated into more efficient units that use modern technology. Also, responsibilities for interagency policymaking should be clearly assigned.

Finally, all actions must be coordinated to serve the needs of the government as a whole. Because developing a new system is likely to overlap several presidential administrations, it will require firm commitment, clearly identified leadership responsibility, and continuity of purpose. These key ingredients, however, can only exist if supported by a broad and stable bipartisan consensus—including both Congress and the executive branch.

Discussion, Debate, and Congressional Hearings Are the First Steps

As the first step toward implementing a new financial management structure, we think that discussion and debate are necessary on the nature and extent of our financial management problems. We are confident that open discussion will lead to general agreement that these problems are widespread and serious, and that they warrant a broad rebuilding of the overall structure.

This agreement might best be achieved through a series of congressional hearings that build on prior congressional efforts to improve financial management, such as the 1921 Budget and Accounting Act, the 1950 Budget and Accounting Procedures Act, the Congressional Budget Act of 1974, and the 1982 Federal Manager's Financial Integrity Act. These hearings could result in the passage of a bill or resolution setting forth the objectives of the long-term rebuilding effort, identifying the leadership for the effort, and specifying an initial timetable. A comprehensive list of objectives might include:

- full disclosure of costs and financial commitments for all government activities;
- strengthened accounting, auditing and reporting, using consistently applied and comprehensive accounting principles and standards;

- consolidated financial statements for the federal government, audited annually;
- a structured approach, such as planning and programming, for considering the long-term consequences of major policy choices;
- a more manageable and understandable federal budget process;
- cost-based budgeting and accounting;
- greater visibility for capital investments within the unified budget;
- reports for major projects showing planned versus actual costs and accomplishments;
- performance information that is integrated with the financial management structure and reports.

All Those Affected By the New System Should Participate In Designing It

Organization and leadership of that effort will be critical. The effort may well be led by the General Accounting Office and the central financial management agencies—Treasury and OMB—through the Joint Financial Management Improvement Project. All those who will be affected by the new system, including Congress, Congressional Budget Office, and the operating departments and agencies, must have a strong voice in its design. The system must serve the needs of all participants.

These Issues Are
Discussed Further In
Volume II—Conceptual Framework
GAO/AFMD-85-35-A

Federal Government Reporting Study

A Joint Study by
the Office of the Auditor General of Canada
and
the United States General Accounting Office

This document is one of four publications produced as a result of the Federal Government Reporting Study. These documents include:

Summary Report (GAO/AFMD-86-30)

Illustrative Annual Financial Report of the United States Government (GAO/AFMD-86-30A)

Illustrative Annual Financial Report of the Government of Canada

Detailed Report (GAO/AFMD-86-30B)

The Detailed Report contains the complete Summary Report, both U.S. and Canadian Illustrative Annual Financial Reports in their entirety, as well as the detailed findings of the project. These documents can be obtained from:

United States:

U.S. General Accounting Office
Post Office Box 6015
Gaithersburg, Maryland 20877, U.S.A.

Canada:

Office of the Auditor General of Canada
11th Floor
West Tower
240 Sparks Street
Ottawa, Canada
K1A 0G6

Kenneth M. Dye
Auditor General of Canada

Charles A. Bowsher
Comptroller General of the United States

International Advisory Group

W.D. Grace
former President of the Canadian Institute of Chartered Accountants

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Summary Statement

by the
Auditor General of Canada and Comptroller General of the United States

Federal Government Activities Affect All of Us

The governments of Canada and the United States are continually involved in financial transactions and commitments amounting to billions of dollars that affect every segment of each nation's economy. Massive federal programs encompass housing, health, education, income security and defence. Finding the money to pay for these programs has an enormous impact on financial markets.

Federal Government Reporting is Important

To a large extent, knowledge about the significance and financial impact of these federal government activities is communicated by information contained in financial reports. Some people have a perception that the variety of ways in which information can be presented in financial reports is an esoteric matter of interest only to accountants and of no great relevance to those who actually make financial decisions. The results of this study clearly show this not to be so; in fact, quite the opposite. Many individuals consulted during the study, including those within and those outside government, not only use federal government financial information, but had many suggestions to enhance the usefulness of the information they are now getting.

The people needing such information include those who have primary responsibility for making and implementing government policies - the legislators and government managers - and those external to the government who are concerned with or affected by its policies - citizens, corporations, lenders, analysts and the media. The understanding of government activities by any of these groups is significantly affected by the form and content of the government's financial reports.

Legislators and government managers struggle with fundamental questions such as whether proposed spending levels are necessary and affordable in view of resulting deficits and existing liabilities. To assess properly the financial implication of such proposals, they must have a clear and complete picture of where the government stands financially, what financial commitments it already has for the future, and the full cost of proposed programs. Good financial information is needed not only at the program level but also at the overall summary level.

People outside the government also need and use federal government financial information in their day-to-day work. For example, lenders need summary information to help them anticipate government cash requirements and their effects on financial markets. And members of the media need both summary and detailed information to analyse government activities for reporting to the public.

Sound Financial Management Systems are Needed

We believe that the specific information users need, both at the overall summary and detailed program level, can be satisfied. But to do so, the government needs sound financial management systems and procedures and strong internal controls. Such systems and procedures carry their own reward since they foster more efficient and effective management of the sizeable economic resources under the government's control.

Consensus is Needed on What Financial Information Should be Reported

In spite of the real interest in government financial reporting, there has been no consensus on what information federal governments should record and report. Many hypotheses have been put forward but, until recently, there has been little organized effort to reconcile conflicting views and obtain consensus. The time now seems most appropriate for such an effort.

In Canada, Parliament and the federal government have expressed an interest in making changes to Canada's financial statements that would make them more useful and understandable. Also, the Canadian Institute of Chartered Accountants (CICA) has created a Public Sector Accounting and Auditing Committee. The Committee has defined the primary objective of government financial statements as the communication of "reliable information relevant to the needs of those for whom the statements are prepared in a manner that maximizes its usefulness".

In the United States, many Members of Congress, public and private groups and government executives have expressed a need for improvements in financial management and reporting. In this respect, the General Accounting Office has been seeking to establish integrated budgeting, accounting and reporting systems to produce clear, relevant and timely information so that government programs can be managed most effectively to control costs and produce desired results. In the course of this initiative, providing information to satisfy users' needs is recognized as a basic reason for establishing sound financial systems. Similarly, the U.S. Governmental Accounting Standards Board is working toward identifying users' needs to assist in developing generally accepted accounting principles for state and local governments.

Knowing What Users do With Financial Information Should Help Build Consensus

The similarity of the situations in Canada and the United States led us to initiate this Federal Government Reporting Study (FGRS) as a joint project. The central focus of the study rests on the belief that the needs of users of federal government financial information should guide the presentation and extent of government financial reporting.

We believe strongly that identifying and understanding users' activities and financial information needs are the starting points for building consensus about the form and content of financial reports. We believe that this consensus, once achieved, can and should extend to other levels of government. Representatives of the CICA Public Sector Accounting and Auditing Committee and the U.S. Governmental Accounting Standards Board have indicated that the FGRS findings will provide useful input to their standard-setting efforts. Accordingly, the essential objectives of FGRS were to identify and understand what financial information about the government users need, and for what activities they need it.

We Now Have an Understanding of Users' Needs

The results of FGRS are described in this report. The study found that users of government financial information had concerns about the information they have been getting, and were able to articulate and describe their needs for information with a fairly direct linkage to their activities. Detailed findings of the study are set out in Chapters One and Two but some highlights are worth mentioning here.

Users Depend on Each Other

The study showed that although the user groups selected did in fact need federal government financial information, they did not always get the information direct from government financial reports. A significant overall finding was that users depend on each other for the communication of financial information about the federal government. Legislators – generally considered to have a primary role in the use of federal government financial information – depend to a considerable extent on the interpretations of information by analysts and the media to provide them with the understanding they need. This also applies to citizens and corporations. Thus, needs of analysts and the media are considered crucial because, if they are not well served, the understanding of government activities by others will suffer.

Users Need an Annual Financial Report of Government

Perhaps the most significant finding was the prevailing view of user respondents that a comprehensive but concise Annual Financial Report of the federal government would be extremely valuable. They want such a report to provide a broad and complete picture and understanding of the government's many and varied activities and resulting overall financial position, and to serve as a key into the more detailed information the government now provides in other financial documents.

Users See a Need for Integrated InformationSystems

Users need a wide variety of financial information at various levels of detail, from summary information about cash requirements to detailed information about the cost of programs. They emphasized the importance, for comparability and credibility, that information reported at every level come from one integrated data base to ensure that detailed information is related easily to summary-level information.

Both External Users and Management Need Cost Information

The most significant potential impact on governmental accounting systems flowing from FGRS is the expressed need of external users for information about physical asset holdings of the government and full program costs. To provide this information would require that the costs (or values) of fixed assets and inventories consumed in government operations be identified as they are used or sold. Because of the importance of this matter, FGRS included a review to determine whether that same information is needed for management purposes.

The conclusion of this review is that managers do need systems that provide information about physical assets and program costs. In some programs, asset costs are not significant and allocation of such costs to the programs is relatively simple; in other programs, larger systems are needed.

Although the development of systems to provide this information will require an investment of time and money, the need to do so for internal purposes has been widely recognized in both Canada and the United States. To provide the information that external users seek should not impose special, costly systems that are beyond those required for good internal management.

Where We Go From Here

As part of FGRS, illustrative Annual Financial Reports of our respective governments were developed as research and discussion tools. Based on users' responses, reports like these could provide much of the summary-level information users need. In our view, the federal government in each country should move toward developing a comprehensive Annual Financial Report responsive to the users' needs identified in the study.

In Canada, the Annual Financial Report could be an official document of the Department of Finance and Treasury Board (Office of the Comptroller General) and become a revised Volume 1 of the Public Accounts or, preferably a new official financial report. In the United States, the Annual Financial Report could, in time, replace the present prototype Consolidated Financial Statements, to become an official document of the U.S. Treasury.

Many unanswered questions still remain. Several major technical issues require further research. For example:

☐ How should fixed assets be defined, valued and depreciated?
☐ Should the financial statements of all government majority-owned corporations as well as the central banking system be consolidated with those of the federal government?
☐ How should Social Security and the Canada Pension Plan be reported?
☐ How should tax expenditures be reported?

Questions such as these will require the co-operative work and consideration of our governments, our professional organizations and our own Offices.

Our common interest is in the development of consistent accounting and reporting standards that are based on users' needs for financial information. Well thought out standards on this basis will have immense value in improving the relevance, comparability and credibility of financial reporting of governments at all levels.

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21 March 1986

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Chapter One
The Users - Their Activities and General Information Needs

User Groups Selected Based on Expected Interest

The important first step of the project was to identify the user groups. A list of potential users was compiled from a review of literature, the experience of the FGRS Core Group members and their advisers, and discussions with other advisers to the study. Users were included if they could reasonably be expected to have an interest in financial information about the federal government. They were combined into six groups to simplify carrying out the research.

The user groups identified were:

☐ legislative users;
☐ citizens, the media, policy analysts, special interest groups and other levels of government;
☐ government planners and managers;
☐ economists;
☐ corporate users; and
☐ lenders, security dealers, and their advisers.

The responses of each individual contacted within each group were carefully analysed to prepare a detailed profile of each group. This chapter describes the groups, the general nature of their main activities and financial information needs, and the inter-relationships among the groups.

Legislators

The legislative users included Members of the House of Commons and Senate in Canada, and Members of the House of Representatives and Senate in the U.S. (hereafter referred to as Members). Also included were intermediary agents, such as legislative staff and researchers assigned to Members, to a political party or to committees and task forces. Members who are Cabinet Ministers (Canada) were excluded from this group and included in the Government Planners and Managers group.

Citizens, Media, Policy Analysts, Special Interest Groups and Other Levels of Government

This group was somewhat heterogeneous. Analysts included primarily those that work in universities, non-profit research organizations and special interest group organizations such as those representing labour, consumers, physicians, etc. Other levels of government included provincial, state and municipal governments.

Government Planners and Managers

Government planners and managers included Cabinet Ministers or Secretaries and officials of departments, agencies and government-owned corporations. The emphasis in the study of this user group was placed on management's needs for financial information to demonstrate accountability for its responsibilities and on the information it needs to manage. The latter emphasis was narrowly confined to management aspects that would have a direct bearing on issues under consideration in FGRS, rather than seeking to examine all financial information needs for managing government activities. Within these limits, the needs of planners and managers were considered from the perspective of both the central level of government and that of departmental or agency programs.

Economists

In this group the activities and related uses of financial information about the federal government concentrated on macro-economists. In Canada, the activities and needs of central bankers and those who prepare the National Accounts were also investigated. Micro-economists were included to the extent that they are concerned with the behaviour of the federal government as an economic agent interacting with other agents in the economy.

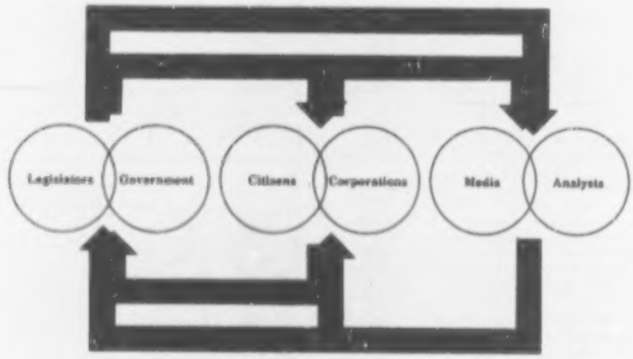
Corporate Users

Corporate users included Canadian and U.S. industrial, retail and service corporations and Canadian commercial government-owned corporations, but excluded financial institutions, which were covered separately. Major industry and small business associations were also included.

Lenders, Security Dealers, and Their Advisers

The primary focus in this area was on those users who analyse financial markets and prepare short- and medium-term market forecasts.

Exhibit 1



Inter-Relationships Among User Groups

An early finding of the study was that user groups varied greatly in their ability to describe their information needs clearly and to relate specific information needs to their specific activities. They also differed in how they obtained financial information about the federal government. Some user groups seldom used federal government financial reports directly, relying instead on other users to process the information for them. To get a better understanding of the differences and relationships among user groups, the central Core Group integrated the early findings from all six study areas into a model of user activities and information flows. Exhibit 1 shows this model.

User Groups Fit into Sets

The model organizes the six user groups, by the nature of their activities, into three sets, each set represented by two overlapping circles.

□ First Set: Legislators, Government Planners and Managers

Users in this set have responsibility, directly or indirectly, for the flow of financial information to other users. They also have responsibility for the real effects — the impact of government activities on people and organizations in society — to which the financial information relates.

□ Second Set: Citizens, Corporations

These are the beneficiaries of federal government operations. Through taxes, they also pay the bills. Other levels of government are not shown on the model. Some are similar to corporations in their use of information, others do extensive economic analysis and have information needs similar to those of the third set of users.

□ Third Set: Media, Analysts

Users in this set are concerned with analysing and disseminating information. Analysts include social policy analysts, economic analysts and the financial market analysts in the lenders' group.

Direct Flow of Information

At the top of the model, the main flow of financial and operating information is shown as going direct from government to the media and analysts. It must be remembered, however, that the reported financial information reflects government activities that have a real impact on citizens and corporations. In various ways, information about these real effects reaches media and analysts. The latter combine the financial and other information in reports and commentaries that are read by citizens and corporate users, legislators and government planners and managers.

Indirect Flow of Information

Citizens and corporate users, for the most part, do not read the financial reports of the federal government. They have neither the time nor the expertise to analyse such information in terms of its significance in their planning, investing, financing, lending, borrowing, spending and saving activities. They look to analysts in the media, financial institutions, policy institutes, etc., to do such analysis for them.

Canadian legislators, although they are direct users of federal government reports in many of their legislative activities, also rely heavily on the media and outside analysts for reports on the social and economic effects of government activities. They often have difficulty getting access to the federal government's own studies of this type and suffer the same constraints of too little time and a lack of expert knowledge as do the citizens and corporate users. They also point out that, in addition to being a source of information, many reports of the media, analysts and special interest groups demand a political response.

Legislators in the U.S. often turn to professional staff to interpret and analyse financial data in areas of special interest to a Member, but they also rely heavily on the media and outside analysts for interpretation of data outside their own area of specialization.

Most Frequent Direct Users

In considering the study's findings on the information needs of the different user groups, it is important to keep in mind the role played by the media and analysts. They are the most frequent direct users of federal government financial reports, the major source of information about the government for citizens and corporations, and an important source of information for legislators. Federal government financial reports will serve the needs of legislators, citizens and corporations well only if the needs of the media and analysts are adequately met. By the same token, the media and analysts are the users best able to define clearly the nature of the financial information about government that they need and the characteristics that such information should have to suit their needs best.

The description of user activities and financial information needs in the balance of this chapter is organized to follow the grouping of activities shown in Exhibit 1 because of the common interests of users within these sets.

Legislative Users

Members in Canada Tend to be Knowledgeable Generalists

In a parliamentary democracy such as Canada, the role of individual Members of Parliament or the Senate is to monitor, evaluate, judge and decide on the proposals, policies and actions of "the Government" on behalf of the people they represent. To discharge this responsibility effectively, most Members, according to those we interviewed, do not feel the need to be "experts" in any particular area, although there are some exceptions in the case of Members that have an interest and expertise in a specific program. As one experienced Member put it, it is necessary that they be "knowledgeable generalists". This is a very important point and holds significant implications for the kinds of information they need and want.

Canadian Members indicated that they realize that most of them will never have the detailed knowledge that government officials have concerning a particular policy, piece of legislation or the operations of existing programs. This is largely true even for those who have a special responsibility to speak in a particular area of public policy. What they need and want is access to consistent and understandable data and information that will assist in identifying the right questions to ask in making their assessments. These questions will in turn help to identify potential or actual problems with regard to policies, legislation or programs.

Need for Key Financial Indicators

Canadian Members expressed a strong desire for summary-level information that will allow them to see trends in key financial indicators (such as level of debt and spending in relation to Gross National Product) and to obtain a broad perspective on a policy or program issue. This is true for both the macro-level (overall spending, taxing and borrowing) of government operations and the operations of a particular department or government-owned corporation. The desire almost always tended to be for information that would enhance their ability to become "knowledgeable generalists", capable of seeing the main issues despite the complexity of the particular subject at hand. They expressed a need for a clear picture of the financial affairs of the government to facilitate the tasks of pursuing accountability and of evaluating the financial effects on society of government actions.

General Qualities of Financial Information

Overall, Canadian Members wanted financial information supplied by government to be consistent (over time and from different sources), easy to obtain, quickly digestible and easy to understand. This would enable them to make quick use of it with a minimum of introduction and learning, and to avoid being confused by inconsistent information from the variety of sources available. They also need reports and documents that provide summary data in a form that can be used easily and effectively in communicating with constituents and others. Information is needed in a form that leads from the general to more specific levels of detail to facilitate policy discussions. For those interested in investigating a particular issue, program or activity, summary-level financial information should include references to sources of more detailed information on a particular topic.

Legislators Convey Financial Messages to the Public

Communication with the public also requires Members to acquire knowledge of a broad range of information including that relating to aggregate measures of economic performance (such as inflation, employment and unemployment, economic growth, and productivity), levels and distribution of taxation, and spending by government departments, agencies and government-owned corporations to implement various policies and programs. Where possible, the information should be broken down geographically and demographically. Such information and analyses of it would be used directly in communications sent to constituents as well as to others.

Legislative Activities Require Financial Information

The financial information needed by Canadian Members to perform their legislative activities, such as considering and debating policy issues, is similar to that required for their public communication activities. It should be presented in a way that allows them to move easily from summary-level data to the more detailed accounting of the particular issue of concern. For example, information should allow first an overview and then a more detailed analysis of the activities and performance of individual departments, agencies and government-owned corporations. In addition to information on direct expenditures, Members need information on "tax expenditures", as discussed in Chapter Two, and so-called "credit budget" items such as loan guarantees. Revenue and expenditure figures should also be broken down in ways that permit legislators to make a better assessment of the distributive impact of the government's activities by relating them to various sectors and components of society.

In carrying out their parliamentary activities, Canadian Members want to be able to compare reported actual results with forecasts in the Budget and Estimates (requests for spending authority) and with spending and borrowing limits set by acts of Parliament. It is essential, therefore, that there be consistency in classification and format among the basic financial reports of the government.

Legislators Need Financial Information to Represent Diverse Interests in Society

In addition to representing the interests of people in their ridings or regions, Members in Canada must respond to, and may wish to represent, the interests of other groups in society. Such groups may consist of generalized segments of society, such as the poor or the aged, or of individuals with common interests, such as conservationists. Many types of national and local lobby groups are included. The demands of these groups are often specific and relate to particular aspects of government policy. In representing or in responding to special interests, Members need both summary-level financial information, as background for their consideration of policy proposals, and detailed information, to help them assess the likely costs and benefits of the proposals. They would be greatly assisted by having available an Annual Financial Report as a source of consistent and comprehensive summary financial data and as a reference document to direct them to sources of more detailed and complete information. Members stated that they would have more confidence in the reliability of such detailed data if it could be easily related and linked to the audited information in an annual summary-level financial report. An Annual Financial Report should therefore be thought of as a basic working tool for Members.

Members of the United States Congress

The government of the United States is characterized by a strong emphasis on the balance of power between the executive, the legislative, and the judicial branches of the government and on the representative role of the Senator or Congressman. Unlike the Canadian House of Commons, the U.S. Congress can and does make policy that the executive branch is expected to carry out. The President's legislative initiatives, if accepted at all by Congress, are almost always modified.

With oversight activities in almost all federal programs, the U.S. Congress has become more and more intimately involved with the workings of the financial management of the federal government and the individual programs.

Views of U.S. legislative users identified during FGRS are summarized below.

☐ Unlike Canadian Members, U.S. Members specialize in and become "experts" in the areas of their particular committee responsibility. For this activity, they and their professional staffs need specialized agency and program financial information on a regular basis, and would use an Annual Financial Report as a reference document to lead to more detailed or disaggregated information in specific areas.

☐ The public communication, legislative and special interest representative activities of U.S. Members are similar to those of their Canadian counterparts. Accordingly, U.S. Members need similar summary-level information. They would use an Annual Financial Report primarily as a medium for communicating a picture of the totality of the federal government to constituents and others concerned about government finances, and as a means of communicating the federal government's interest in accountability. The current concern with the overall budget deficit highlights the need expressed by some legislators to look more at the full financial picture of the federal government as opposed to segments of it.

☐ U.S. Members also need to see trends and to obtain a broad perspective of total government operations with easy-to-understand information that can be grasped quickly. Accordingly, they want financial information supplied by government to be consistent over time and across activities, easily retrievable and understandable.

Government Planners and Managers

Three of the major activities of government planners and managers were identified as:

☐ seeking authority for taxing, spending and borrowing;
☐ managing government programs and activities; and
☐ demonstrating accountability.

The FGRS review centred on the need for information to demonstrate accountability for the management and use of public resources. In this regard, five areas were identified in which planners and managers have significant responsibilities. These are to:

☐ monitor the socio-economic impact of their activities,
☐ finance the government as an institution;
☐ comply with legislation, regulations and rules;
☐ ensure the economical and efficient use of resources; and
☐ meet legislative objectives of programs.

These five responsibilities create a need for two types of financial information.

☐ summary information, to be used in assessing socio-economic impact and financial position of the government; and
☐ detailed disaggregate information, for reporting and measuring compliance, resource management and cost-effectiveness.

Significant aspects of these two major information needs are reviewed below.

An Annual Financial Report Would Increase Credibility of Management and Discipline in Systems

Essentially, government planners and managers have two perspectives on the use of federal financial information. As officials with agency-specific responsibilities, government planners and managers generally need information that is highly specialized and unique to the program being managed or reviewed. An Annual Financial Report with summary-level financial statements for the entire federal government would have limited use for these activities.

However, as officials with government-wide responsibilities, government planners and managers would use an Annual Financial Report to present an overall picture of the financial health of the government that is not available elsewhere. Such a report would be a useful means for reporting on managers' stewardship of federal resources and on how government operations were financed. It would also provide managers with a general framework to situate their own activities.

A comprehensive, understandable Annual Financial Report would provide evidence of the integrity of the government's management of public resources and increase the credibility of government managers in the public eye. Also the very requirement to produce such a comprehensive document on a consistent basis would foster more rigorous, disciplined financial management systems and practices throughout all levels in government.

The Use of an Annual Financial Report to Demonstrate Compliance is Limited

Managers believe that summary financial reports are not very effective for demonstrating compliance with spending authorities given by legislators, because the authorities are detailed rather than summarized in nature. Even a comparison of planned and actual expenditures is considered to have limited meaning if, as would be the case for a summary report, one is unable to relate the comparison to a detailed description of the purposes of the spending.

Managers believe legislators would rely more on their auditor to report instances of non-compliance with individual authorities than on information in an Annual Financial Report. However, what an Annual Financial Report both can and should do is provide legislators with a summary of over-expenditure by department or agency, and some form of overall statement from central government Ministers or Secretaries and/or their deputies, wherein they certify that systems of financial management and internal control have been established to provide reasonable assurance that all activities have complied with the relevant authorities.

Government Performance Should be Measured and Reported Consistently

Accountability of government planners and managers is expressed by comparing their performance with legislated objectives and with standards, plans, prior period results, and other organizations. To this end, financial performance measures must be consistent over time and prepared on a basis that permits meaningful comparison with other measures of performance. Comparability with other jurisdictions would be helped by using, where appropriate, accounting principles that are generally accepted for use by other governments and sectors of the economy.

Information is Needed about Both Government Spending and Program Costs

Government planners and managers acknowledge a responsibility to demonstrate their effectiveness in achieving social and economic policy objectives as well as the economy and efficiency with which government programs are carried out. They also see a need to report information on the level of government spending to demonstrate the correlation between government financial activity and short-term economic impact.

To demonstrate the efficiency of their operations and changes in efficiency between years, government managers see a need to report the full cost of the programs they manage. To ensure its credibility, such cost information should come from the integrated accounting system from which the Annual Financial Report is prepared.

Citizens and Corporations

Citizens and Corporations Try to Anticipate the Impact of Government Operations

Significant activities of these groups relate to the goals of generating income, building savings and improving the standard of living. Their main interest in federal government financial information is in trying to anticipate how the government's past and future actions will affect these goals. Specifically, they plan for the future, invest their resources, finance their expenditures, lend, borrow, spend and save money, and promote their own interests. The citizens, of course, also vote.

Information used in carrying out these activities includes tax rates and forecasts of interest, inflation and exchange rates. Although the preparation of these forecasts requires financial information about the federal government, citizens and corporations do not generally use or refer to government reports themselves. They rely on analyses and reports prepared by other user groups such as the media, economists and financial advisers.

Government Credibility is Clearly Related to Financial Information Reported

Nevertheless, citizens and corporate executives expressed an interest in being informed about the efficiency, effectiveness and propriety of government operations. Corporate leaders in particular expressed a strong desire for comprehensive and rigorous financial reporting as a means of generating confidence in the way the government is conducting its affairs. This need for information is not clearly related to any specific decisions or activities. But these users emphasize that it does have an important bearing on the government's credibility and their confidence in their country as a good place to invest for the future. It also helps corporate leaders and individuals generally to become knowledgeable, responsible citizens.

Media and Analysts

Media and Analysts are the Biggest Users of Government Financial Reports

These are the most frequent direct users of federal government financial reports. They include members of the media, economists and lenders, together with special interest groups and various other analysts in universities and private institutions. Some use information about the government every day. Apart from those active in the market for government securities, their role is primarily one of analysis and communication, and they are fairly specific in articulating their information needs. Although in this role they are generally not making decisions, their activities and needs are very important because the quality and integrity of their analyses and reports are essential to those who *are* making decisions - legislators, government planners and managers, corporations and citizens.

Their Diverse Information Needs Have Some General Characteristics

The financial information needs of these groups are as diverse as the many different kinds of reports and analyses they prepare. Nevertheless, there are several characteristics that are common to their information needs. A fundamental concern of these groups is to obtain a clear understanding of government finances and activities at the summary level as an overview and lead-in to detailed analysis. Accordingly, they need financial information organized in successive levels of detail, starting with a succinct overall picture of federal government finances, what it owns and what it owes, where its revenue comes from and how it is spent.

The very diversity of the financial information needs of these direct users requires that financial reports be organized to provide maximum flexibility in the use of the information presented. Summary information should be referenced to supporting detailed information that should be consistent and coherent with aggregate information. Where possible, detailed information should be cross-classified and referenced to other sources of related or more detailed information. A further requirement is that information should be presented objectively, without bias; estimated or projected information should be accompanied by a clear description of the assumptions and methods used in calculating it.

Information is Used for Analysis and Comparison of Variations and Trends

Most analytical work involves investigating relationships between financial information and other economic and social information. It is important to these users, therefore, that financial information on government activities be classified and presented in such a way that it can be related to observed or predicted social and economic effects of the activities.

For analysis of social impact, program efficiency and long-term economic effects, information is needed to show both the acquisition and consumption of resources in the periods that they are acquired and consumed. The cost of long-lived physical assets would be allocated (as depreciation) over the periods in which they provide benefits. For short-and medium-term analyses of financial market and other economic effects, information is needed on the aggregate cash flows arising from operations and from acquiring and disposing of long-lived physical assets, acquiring and holding investments, and incurring and discharging liabilities.

Analysts often wish to examine trends in reported financial information and compare the trends with related non-financial information or with the performance of other governments. Therefore, they need accounting policies and classifications that remain relatively consistent from period to period. To the extent possible, they need reported information that covers consecutive periods of at least 10 years, in both current and constant dollars. Where accounting changes are made to improve the relevance or reliability of reported information, they need amounts reported for prior periods to be adjusted accordingly.

Information from Different Sources Needs to be Comparable

Much of the analysis carried out by these groups of direct users depends for its rigour on the comparability of forecast financial information with actual financial information, or on the comparability of federal government financial information with financial information on other sectors of the economy, other levels of government or foreign governments. Therefore, they need financial information in government budgets, estimates and historical accounts all prepared in accordance with the same accounting policies and classified in the same manner. To the extent possible, they need accounting policies for the federal government that will provide comparability with other sectors of the economy and other governments, both domestic and foreign.

Analysts must have a clear understanding of the exact nature of the information they are using to ensure that they are using it meaningfully. To this end, they need a full description of the accounting policies followed in the preparation of financial information and of the nature and effect of changes in the accounting policies from those followed in the prior period.

Users Want a Full Picture of All Activities of All Government Entities

Analysts and members of the media study and report on the size and growth of the federal government and on the scope and influence of its activities. They stressed that, to ensure they have a complete picture, they need a summary financial report that encompasses all activities of the government, including those of its various agencies and government-owned corporations. They find that the abundance of detailed financial data published by the government does not give them a succinct, comprehensive and understandable overall picture. Similarly, the report should provide information on activities that do not necessarily require an outlay of funds, such as tax expenditures, insurance programs and loan guarantees.

Media Have Limited Time for Analysis

A particular concern of members of the media is that financial information be presented in ways that they can readily communicate to their readers, listeners or viewers. For this purpose, they need graphic displays of the relative magnitudes of various activities such as spending, taxation and borrowing, and their trends over of time. This, together with per capita and percentage of Gross National Product displays, helps overcome the communication barrier imposed by large numbers. They also need graphic displays of changes over time in economic indicators that can serve as overall measures of performance or help to explain period-to-period variations in reported financial information.

This chapter has summarized the activities and use of federal government financial information described by the user groups. Chapter Two relates users' needs for information to specific accounting and reporting issues, particularly with respect to an Annual Financial Report.

These chapters are summaries of the detailed findings provided in a complete research report, the Federal Government Reporting Study Detailed Report, also a joint publication of the Office of the Auditor General of Canada and the United States General Accounting Office. The research report sets out in detail the study approach and methods and the individual findings related to all user groups, describing the various activities of each group and their related financial information needs. To gain a full understanding of the findings of each user group and the research methods employed, reference must be made to the supporting details in that publication.

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Chapter Two
The Issues - Specific Information Needs of Users

The FGRS research effort was carried out in Phases II and III, as described in Chapter Three. In Phase II, the researchers developed a comprehensive picture of the activities and information needs of those groups in society that use financial information about the federal government. The user groups, their activities and the general nature of their information needs were described in the preceding chapter.

Based on the Phase II findings and on generally recognized issues in government financial reporting, the researchers set out, in 16 main questions and a series of sub-questions, the accounting and reporting matters that required more detailed investigation in Phase III. This chapter describes the 16 issues and the results of the Phase III investigation of each. The results described are based on an analysis of detailed reports on each user group that were prepared from a summarization of the comments of individual respondents. An explanation is provided of how each issue has been treated for purposes of developing the Canadian and U.S. Illustrations of an Annual Financial Report.

The research method followed in FGRS was exploratory. Users interviewed or consulted were selected judgementally, as explained in the next chapter. Throughout this chapter, expressions such as "most users", "many users" "some users" or "few users" are used to give an indication of the relative frequency of different responses. In each case, the expression refers only to the users interviewed or consulted during FGRS and should not be taken as necessarily representative of the entire population of users.

Need for an Annual Financial Report

The need for a concise summary Annual Financial Report was expressed by virtually all users in all user groups. Users believe that such a report would bring together in an easily read and understood format a consistent set of basic data about the federal government to:

☐ give an overview of the financial position and operating results of the entire government;
☐ provide a common framework to enhance users' understanding of government operations;
☐ provide a common data base for analysis and for developing and debating policy positions;
☐ provide an historical perspective from which to consider future budget and spending proposals;
☐ assist users in demanding an accountability for actual results by comparison with earlier projections or budget;
☐ provide a key to matters of interest about which users may want further, more detailed information;
☐ facilitate the communication of information on government to others (for example, by legislators to their constituents or by media representatives to their audiences); and
☐ save users the time otherwise needed to search through voluminous reports for desired information about the government and to work out the required reconciliations.

In addition to basic financial information, such as the government's assets, liabilities, revenues, expenses, deficit and borrowing requirements, most users want an annual report to contain other information that increases their understanding of these measures. Supplementary information frequently requested included information on tax expenditures, common measures of the performance of the economy, the effects of inflation, regional breakdowns of revenues and expenses and government employment. Users recognize that such information can be presented in an Annual Financial Report only in a highly summarized format. Nevertheless, they want the information included to highlight matters that they may wish to examine in more detail, and they want the report to include references to where more detailed information may be obtained.

Many users expressed a desire for extensive use of graphs and charts to permit information to be captured quickly and to be communicated easily to others. They wanted the charts to provide data for 10 years, where possible, and to be accompanied by the numerical values to facilitate analysis of trends.

A small number of U.S. users expressed some concern about an Annual Financial Report. Most of these users supported the concept; however, they did not believe that the government could prepare such a report containing information consistent with other government financial documents because the current accounting systems are not fully integrated. Those who did not support the concept of such a report suggested that the information is available elsewhere such as in the Unified Budget.

In developing the Illustrations of Annual Financial Reports the Core Group attempted to adhere as closely as possible to the needs expressed by users. Generally, where user needs conflicted, the conflicts between users were resolved in favour of the alternative that provided the greater amount of information. Much of the information users want is not now available in government reports in the form desired. In some cases, the information has been reworked by the Core Group to the desired form. Because of constraints of time and cost, data have not usually been reworked further back than the two previous years. Consequently, a number of displays that are set out to show information for 10 years include values for only 3 years. Certain information not now available from the government's accounting records has been estimated for purposes of preparing the Illustrations. Where information could not readily be estimated, it has been excluded from the reports, and explanations are given about the information that should be provided.

The Illustrations of Annual Financial Reports are intended as examples only, designed to show one way of meeting users' needs. The present government accounting systems are not designed to produce all the information that would be disclosed in such a report. Hence, some figures presented in these Illustrations represent estimates only as to the approximate amounts involved. Readers of this report should not rely on figures in the Illustrations to form opinions or draw conclusions about federal government operations in either Canada or the United States.

Recognition of Physical Assets

Physical assets comprise inventories of goods held for sale or for future consumption, and long lived or "fixed" assets such as land, buildings and equipment. Under present practice, expenditures on physical assets are accounted for in the same way as other operating expenditures - that is, they are written off when acquired. A possible alternative accounting treatment is to report them as assets when initially acquired (just as investments are treated as assets) and record expense only when they are sold (in the case of certain inventories) or as their benefit is consumed through use. In the case of assets such as buildings and equipment, the measure of benefit consumption is known as depreciation.

Most users wanted physical assets included in reported assets and allocated to expense as they are sold or consumed. Users need this information to get

☐ a complete picture of financial position, including all the resources available to government,
☐ an accurate picture of the size of government;
☐ a complete measure of the annual cost of government services,
☐ a measure of cost that is useful for analysis of trends and for comparison with measures of output or benefit,
☐ an indication of future replacement needs, and
☐ a measure of annual deficit that reflects the consumption of resources to finance current operations.

Government physical assets represent infrastructure important to the economy, and information on physical assets is therefore necessary to understand the impact of government on the economy. Some users stressed the importance of information on physical assets in managing the costs of government operations and the discipline that comes from having physical asset and depreciation records integrated into the accounting system. Many users emphasized the importance of having information on both physical asset acquisition and physical asset consumption. If physical assets are reported as assets until sold or consumed, information about both asset acquisition and asset consumption is provided.

Although most users wanted fixed assets reported and depreciated at historical cost, a number of users wanted them reported and depreciated at market values or at estimated replacement cost. In the United States, some users expressed a concern that the financial position and results of operations, particularly as reflected in the deficit, would be presented too negatively if all physical assets were not included and recorded at their estimated market values. Many of those wanting the information at historical cost appreciated that market values ideally would provide a better measure of financial position and resource consumption, but they were concerned about the possible lack of reliability and accuracy of the estimates required. They suggested that market values be provided as additional information in the notes to the financial statements.

In the Illustrations, inventories are reported in the main financial statements at either their cost or net realizable value, whichever is lower. Fixed assets are reported and depreciated at historical cost. In Canada, information on replacement cost is provided in a note to the financial statements. Fixed assets and depreciation, adjusted for changes in the general purchasing power of the dollar, are included in the reports as supplementary information in the "10 year comparative financial statements in constant dollars".

Review of internal need for cost information. The need for complete information about the consumption of resources, requires the inclusion of fixed assets in reported assets and the allocation of their cost or value to expense as consumed. We refer to such information as "cost information".

FGRS included a review of the utility to government managers of cost information for purposes of sound financial management. In this context "managers" include central government planners and policy makers as well as managers responsible for administering individual programs and activities.

The review comprised an analysis of relevant literature including Canadian government internal guides relating to management information; a General Accounting Office report on managing the cost of government; Canadian and American studies of federal government financial management and other literature dealing with government managers' information needs; interviews with current and former heads and other senior officials of major

U.S. government departments and agencies; and an analysis of views of the former Canadian deputy ministers and retired senior public servants included in the Government Planners and Managers sub-project.

The review clearly demonstrated that cost information – that is, complete information about the consumption of resources – would benefit government managers in all phases of their work, from planning and execution through to evaluation and reporting. A problem that must be recognized is the inadequacy of such information, if it is based only on historical costs, to provide a measure of the periodic consumption of fixed asset values. When resources are consumed, the measurement of real cost must take into consideration not only wear and tear and obsolescence, but also inflation and fluctuations in market conditions. Historical cost is the starting point in recording the value of resources and is normally captured in any accounting system. As time passes, historical cost loses its relevance as a measure of value - either value consumed or value remaining. Measurements such as replacement costs or market values become more important for many of the management activities described below. Nevertheless, historical cost on acquisition is the foundation of any system to account for physical resources and their consumption, and will therefore be available for purposes of external reporting.

If a system of accounting for fixed assets acquired and consumed were implemented, an initial question would be whether effort should be expended to ascertain the historical cost of assets on hand at that time. A possible alternative would be simply to use estimated replacement or market values to begin the system. Either approach would provide information useful for external reporting.

Planning. In planning, government managers need information about the cost or value of available, unconsumed resources in order to make knowledgeable decisions in allocating them to alternative ways of achieving program objectives. These decisions involve comparisons of the value of resources to be consumed in delivering programs with the value of benefits to be achieved from them. Such comparisons also require cost information to analyse alternative ways of achieving the desired benefits economically.

Execution. Many aspects of program execution require complete cost information:

□ To carry out operations with due regard to economy requires that the best or most appropriate resources be obtained for the least cost. Without consistent cost information, attention cannot adequately be given to such economy decisions.

□ Resources acquired must be properly maintained, safeguarded and controlled. The reporting and regular review of the costs (or values) of available, unconsumed resources and their depletion or consumption over time is an integral part of the management discipline required for this purpose.

□ To set an appropriate level of fees for products or services provided internally to other departments or agencies and externally to those outside government, management needs information about the cost of all resources consumed in producing the products or delivering the services.

□ To monitor the efficiency of government operations adequately, managers need cost information to compare the cost of outputs over time and with pre-set standards.

Evaluation. The performance of government programs (and program managers) is measured and assessed by reference to more than their economy and efficiency of operations. It is also important to measure and assess the extent to which programs are achieving their objectives, in terms of effects or benefits realized, and the reasonableness of such achievements in relation to resources consumed. Cost information is required to do this, in addition to many other kinds of information. To be useful in making comparisons, the cost information should be consistent over time and consistent with information provided by other government agencies and other sectors of the economy.

Reporting. As part of the ongoing process of obtaining and using resources to achieve government goals and objectives, managers are well aware of the need to establish and maintain their credibility in the public eye. They do this in many ways, one of the most important of which is by providing financial reports through which they may be held accountable for their actions. Among other things, such reports are needed to show all government assets and liabilities that affect the operations of future periods; the full cost of government activities, particularly those that provide services or products also provided by private industry; the profit or loss for those government activities that are intended to be carried out on the basis of providing a return on investment or recovery of costs; and information to assess whether the value of goods and services provided by government are adequate in relation to the goods and services withdrawn by government from the economy. To provide all this information requires a cost-based, full accrual accounting system.

Conclusion. The conclusion of this review is that government managers do need cost information in all phases of their work. In some programs, physical asset costs are not significant and their allocation is relatively simple; in other programs, larger systems are needed that may take some time to develop.

The need to develop systems to provide cost information for sound financial management within government has been widely recognized in both Canada and the United States. To provide the information that external users seek should not impose special, costly systems that are beyond those required for good internal management.

Reporting Entity

Governments carry out many different activities, some in competition with the private sector, and use many different organizational forms. The issue of the reporting entity is twofold: whether the government's summary financial statements should consolidate all activities of government without regard to their nature or how they are organized; or, if not, what activities or organizations should be excluded from the consolidation and what information should be provided in respect of excluded activities or organizations.

The U.S. findings disclosed no significant divergence in users' needs respecting this issue; most users studied in the U.S. wanted all government activities consolidated regardless of the nature of the activities or the organizational form in which they are carried out.

The same agreement does not hold for Canada. Many users in Canada believed that full consolidation is necessary to disclose fully the financial position and borrowing requirements of the government, to assess the socio-economic impact of government activities, and to assess the size and growth of government. Many others, however, saw a fundamental distinction between the commercial and non-commercial operations of government and wanted two separate consolidations - a basic consolidation of "governmental-type" activities, that excludes commercial activities carried out by government-owned business enterprises, and a separate consolidation of those government-owned business enterprises. Most of these users wanted the government to account for its investment in government business enterprises on an equity basis. On this basis, only the net profits or losses of the business enterprises would be included in the determination of the government's surplus or deficit on operations; their revenues and expenses would not be included.

A few users in Canada saw the central bank — the Bank of Canada — as being a unique institution that should not be consolidated but for which financial information should be disclosed in the government's Annual Financial Report. Others saw the Bank's implementation of monetary policy as being an essential, albeit separately organized, part of the responsibilities of government that should be reflected in the consolidated financial statements.

Many users in Canada also wanted a listing by individual government-owned corporation of summary financial and other data, such as total assets and liabilities, revenues, profit or loss, extent of financial assistance from the government, and number of employees. This information was deemed necessary to assist users to:

☐ understand the significance of government-owned corporations in the economy;
☐ assess their operational performance;
☐ assess the potential implications of their operations on government finances, and
☐ assess their continuing relevance as instruments of government policy.

In the Illustrations, the main financial statements use the broadest consolidation needed by any group of users. The assets, liabilities, revenues and expenses pertaining to all federal government activities, including those carried out by government business enterprises (and, in Canada, the central bank), are included. In response to the needs of many Canadian users, separate information on government corporations is provided in two ways in the Canadian Illustration. Information on transactions and balances of government corporations with outside parties is provided in various notes to the main financial statements which separately identify the assets, liabilities, revenues and expenses of government corporations.

In addition, the expenses and sales revenues of individual government corporations are set out in the supplementary information detailing government expenses by envelope and program. The supplementary information also includes a list of significant details on individual government corporations, which has been extracted from the corporations' regular accountability reports and so includes transactions and balances with departments and agencies of government.

Actuarial Liabilities for Employee Pensions

The government's liability to certain categories of claim-holders cannot be determined absolutely because of uncertainty about how future events will affect the eventual level of payments required by contract or by law. In some cases, for example employee pension plans and social security plans, the amount of the liability can be estimated using actuarial methods. This section addresses the issue of whether users need government financial statements to include the actuarial liability for employee pension plans. The question of information required in respect of social security programs is discussed in the next section.

With few exceptions, users wanted the federal government's financial statements to include the full actuarially-calculated liability for employee pension plans. Such a reporting was considered necessary to show the full liabilities of the government and to have all elements of employee remuneration included in program costs.

In the illustrative Annual Financial Reports, the full actuarial liability for employee pension plans has been included in the financial statements, and explanation of the plans and how the liability is calculated is provided in a note to the financial statements.

Ongoing Social Programs

The U.S. and Canadian governments operate, or contribute to, a number of programs under which individuals become entitled to receive payments. These programs may be funded by special taxes or levies, as in the case of U.S. Social Security and the Canada Pension Plan (CPP), or they may be funded from general revenues. The question addressed to users was whether they needed future-oriented information on social programs included in the summary financial statements.

Almost all users were in agreement that future oriented information was useful. It is needed to assist them in assessing:

☐ future borrowing requirements and taxation levels and the resulting impact on the economy;
☐ the long-term viability of social programs, and
☐ policy options available to control or reduce spending or deficit levels.

Future-oriented information can take the form of an actuarial projection of future benefit payments and future contributions, or the actuarial liability represented by the summation of the present values of the streams of future benefit payments less contributions.

Projected spending levels on other social programs, together with the assumptions used in making the projections, were wanted by most users. Some users, particularly in Canada, felt that the assumptions used in making such projections were likely to be controversial and that including the projections would damage the credibility of the annual report. These users proposed including past trends only and leaving it to the reader to make the projections. To assist the reader in making projections, some users suggested including demographic information in the report.

In both the U.S. and Canadian Illustrations, 10-year historical trend information, in both current and constant dollars, is shown for major social programs in the 10-year comparative financial statements included as supplementary information. Projected expenditures on social programs, on a budgetary accounting basis, are included in the budget projections in the supplementary information section to the extent such information is available in budget documents.

Determination of actuarial liabilities was considered most useful for those programs like Social Security and CPP where there is an identifiable stream of receipts intended to fund the stream of payments. Many users in the U.S. wanted Social Security included in the financial statements on an actuarial liability basis in order to have a total picture of the government's obligations to pay benefits in the future. Some others did not believe that Social Security should be included as a liability; they viewed it as a commitment to an ongoing social program that should be footnoted rather than shown as a liability. Only a few users in Canada wanted the CPP actuarial liability included in reported liabilities. Some were of the view that reporting receipts and payments for CPP as they occurred was more useful for assessing the government's impact on current economic conditions. Other users in Canada wanted CPP excluded from the reporting entity. They viewed the CPP as a separate activity that the federal government, with the participation of the provinces, administers on behalf of contributors.

Regardless of what accounting approach they felt was appropriate for Social Security and CPP, users wanted full disclosure, in a note to the financial statements or in supplementary data, of significant information such as:

☐ the amount of the actuarial liability and change during the year (or the effect that accounting for the actuarial liability would have on the surplus or deficit for the year);

- demographic and economic assumptions used in calculating the actuarial liability; and
- the status of the fund available to meet benefit payments.

FGRS findings do not indicate consensus on how Social Security and the CPP should be reported. The method chosen in the U.S. was to consolidate Social Security in the financial statements by including contributions receivable during the year in tax revenues and by including benefits payable in expenses. In addition, an estimate of the actuarial liability for Social Security is included in the liabilities reported in the financial statements. In Canada, in view of the lack of a consistent preference by users for any one accounting method, and considering the legal and political involvement of the provinces, it was decided to exclude CPP from the consolidated financial statements in the illustrative Annual Financial Report. Detailed information, including the amount of actuarial liabilities and the effects on the deficit of the accounting method chosen, is provided in notes to the financial statements.

Reporting Gold Holdings

Both Canada and the U.S. hold quantities of gold as part of their monetary or foreign exchange reserves. The issue is whether gold holdings should be included in reported assets and, if so, how the gold should be valued.

The issue of how to account for gold holdings was not significant to most users. Of those users expressing an interest, almost all wanted gold included in the financial statements as a financial asset. Users studied in the U.S. wanted gold reported at current market values. Canadian users were divided; most interested users wanted gold reported at current market values, but others wanted gold reported at its official reserve value.

In the illustrative Annual Financial Reports, gold is reported at current market values. The official reserve value of the gold is disclosed in a note to the financial statements.

Accrual of Tax Revenues

Tax revenues are reported by the U.S. and Canadian governments in the period when the taxes are collected or refunds paid. Under the accrual basis, taxes would be reported in the period that the taxpayers' liability to pay the taxes arises. For income taxes, the liability would accrue over the period that taxpayers earn the income that gives rise to their liability.

Almost all users acknowledged that, in concept, accrual information on tax yields is more useful than cash information for economic analysis; it provides more meaningful time series and a more meaningful link to the spending and investing behaviour of individuals and firms. Accrual information is also useful to help forecast cash flows. Some users wanted cash flow information on taxes to assess financing consequences and financial market effects; others wanted it for economic analysis. A number of those users who considered accrued tax revenues to be superior for economic analysis purposes were concerned about the difficulty of calculating accrued tax revenues for self-assessed taxes such as individual and corporation income taxes. Some were of the view that the estimations required in such calculations would result in calculated amounts being so unreliable that they would not be worth the effort of producing them.

Notwithstanding this concern, taxes are reported on the accrual basis in the illustrative Annual Financial Reports to meet the needs expressed by the majority of users. The accruals required can be and even now are calculated. In Canada, estimates of accrued tax yields are made under tax collection arrangements with the provinces for the purpose of remitting their share of tax revenues. In the Illustrations, the accruals for income taxes are based on a combination of actual assessments rendered and estimates of taxes yet to be assessed information is also provided on the balances of taxes receivable and refundable for those users who want to calculate the cash flows pertaining to tax revenues.

Tax Expenditures

Both the U.S. and Canadian tax systems contain special provisions for the taxation of individuals and groups in society based on sources of income, on uses to which income is put or on characteristics of the taxpayers themselves. These selective tax measures take the form of tax exemptions, deductions, credits, reduced tax rates and tax deferrals. Because such tax measures can be used as a substitute for direct expenditures in the pursuit of public policy goals, they are commonly referred to as tax expenditures. The issue is whether the federal government should disclose, in an Annual Financial Report, estimates of revenues foregone as a result of selective tax measures.

The usefulness of information on tax expenditures was stressed by almost all users. It is needed:

☐ to analyse and describe the total size and scope of government;
☐ to assess the equity of concessions granted to individuals and groups through the tax system;
☐ to analyse and describe the allocation of resources to particular uses or policy areas;
☐ to analyse and describe the impact of federal government policies on social and economic conditions;
☐ to analyse and describe the impact of tax arrangements on individuals and firms;
☐ to assess policy choices open to the government in controlling the deficit;
☐ to determine the comprehensive cost of providing specific services or benefits;
☐ to provide insight into possible future policy directions and tax changes;
☐ to forecast tax revenues;
☐ to assess consequences for cash requirements of changes in tax measures; and
☐ because tax expenditures can be substituted for direct expenditures, to hold government accountable for the level of spending relative to statutory ceilings or budgeted plans.

Most users wanted the Annual Financial Report to include either a complete listing of tax expenditures or a listing of major tax expenditures with a reference to where further details could be found. Many users wanted tax expenditures displayed in a manner that would permit them to be related readily to direct expenditures in any policy area. Others wanted tax expenditures identified by type of tax, such as individual or corporation income tax or commodity tax.

Some users were of the view that information on tax expenditures should not be included in an Annual Financial Report because its nature was too conjectural. Some went further to criticize the inference of some tax expenditures that everything in society is taxable. Those users favouring the inclusion of tax expenditures suggested that there should be a clear caution to readers concerning the assumptions and limitations inherent in the information and the consequent limitations on how it can be used. Without such a caution, some readers might inappropriately add up tax expenditures to arrive at a false conclusion as to total foregone revenue.

The illustrative Annual Financial Reports include summary information on major tax expenditures as supplementary information. The information has been extracted from official government reports and includes cautions on its use and references to sources of more detailed information.

Budget to Actual

Federal government budget documents contain estimates of revenues and expenditures for the coming year. The issue for FGRS was whether the Annual Financial Report should include a comparison of the results actually achieved for a year with what was previously estimated.

Most users indicated that they would find useful a comparison of actual to budget. Many users suggested that a multi-year comparison would be more useful than a comparison of one year only. Such a comparison was needed:

☐ as part of the accountability regime to keep a check on government decision making over time;
☐ as an indication of policy changes during a period;
☐ as a measure of how well the government is managing its affairs, and
☐ as an indication of the reliability of budget estimates as a tool for activities such as economic forecasting.

Users did not agree on whether the comparison of actual to budget should be in the main financial statements or presented as supplementary information. Some users wanted the comparison made on an agency basis rather than a functional or envelope basis; others wanted the comparison made on a more detailed project or program level.

Many users stressed the desirability of having budgets prepared on the same basis as used in the main summary financial statements. Complex reconciliations were seen as confusing to readers and leading to reduced credibility for the annual report. However, revenue and spending forecasts are now presented on a cash or modified cash basis in budget documents; this differs considerably from the accrual basis that users need for historical information as illustrated in the Annual Financial Reports. Until budgets are prepared on the accrual basis, some form of reconciliation will be needed in the Annual Financial Report in order to compare historical results with budget forecasts and hold the government accountable for its performance.

The illustrative Annual Financial Reports include a multi-year comparison of budgeted revenues and expenditures with the results actually achieved for those years. Also included is a reconciliation for the current year of revenues and *expenditures* on a budget basis, with revenues and *expenses* reported in the illustrative consolidated financial statements. (A description of the budget basis of information and the difference between "expenditures" and "expenses" is included in the subsequent section, "Measures of Deficit".) In Canada, the reconciliation is included in supplementary information; in the U.S. the reconciliation is part of the primary financial statements. The reconciliation is necessarily complex because the illustrative consolidated financial statements incorporate the many changes from present reporting practice that users have indicated they need.

Timeliness of Reports

During Phase II of FGRS, many users expressed dissatisfaction with the timeliness of federal government financial reports. This issue was further investigated in Phase III to determine how soon after the year-end users needed the reports to be available and the frequency of interim reporting that would best suit their needs.

For most users, the utility of information decreased the later it became available. These users were generally willing to sacrifice some accuracy to get more timely information. For purposes of some types of analyses of economic behaviour, the accuracy and consistency of time series were more important than timeliness. A number of analysts were therefore willing to accept reasonable delays necessary to improve the reliability of accounting estimates.

For most users, availability of the Annual Financial Report three or four months after the year-end was adequate. They also required current information to be available from interim condensed monthly or quarterly reports throughout the year. Some users believed the government should be able to match the corporate sector in producing summary annual reports within one or two months of the year-end. Those using both government annual reports and National Accounts as information sources wanted government quarterly reports to be available when National Accounts reports are available - 60 days after the end of each quarter.

Adjustments for Inflation

Financial statements prepared on an historical cost basis, unadjusted for changes in the purchasing power of the dollar, do not present, in periods of inflation or deflation, a realistic measure of changes in net worth during a period or a meaningful portrayal of trends over several years. Although all users acknowledge the distortions to financial reports caused by inflation, they are not in agreement on how the distortions should be corrected, or even that they should be corrected.

Some users want assets and liabilities reported in the main financial statements at current market values as part of a full current value determination of financial position (net worth) and surplus or deficit (changes in net worth). Most users are concerned that current value accounting requires a degree of estimation that would undermine the usefulness of the figures. They want the main financial statements to be prepared on an historical cost basis without adjustment for changes in the purchasing power of the dollar. Some of these users agree that a 10-year time series of inflation-adjusted information is useful as supplementary information. Users wanting inflation-adjusted information as supplementary information do not agree on how it should be calculated. All users agree that, if inflation-adjusted information is presented, there should be a clear description of the methodology and the source of indices used as deflators.

In the illustrative Annual Financial Reports, 10-year comparative financial statements in constant dollars are presented as supplementary information. The adjustments to historical dollars used in preparing these financial statements are based on a general purchasing power index as explained in the reports. While the reports contain some information on current market values or estimated replacement values, time constraints and limitations of readily available information did not permit a full illustration of the effect on financial position and results of operations of using full current value accounting.

Measures of Deficit

Financial statements that report activities of an entity for a period customarily come down to a "bottom line" representing the difference between resources obtained or received during a period and resources consumed or spent during the period. Those statements can report all resource inflows and outflows to the entity for the period or just some of them (for example, the statement might be limited to cash inflows and outflows). Users of financial statements seem to want the quick snapshot of results that is provided by the bottom line. The problem is that different users are interested in different indicators of results. Some are interested just in cash inflows and outflows. Others are interested in more complete measures of results of operations showing results in terms of the net position of other assets and liabilities as well as cash.

In government accounting it has been customary to call the bottom line in a statement of operations the "deficit" for the period. The term deficit, however, lacks meaning unless the statement reader knows what it is that is being accounted for. Is it just cash flows or is it something more? In the course of FGRS, users were asked what definition of "deficit" they would find most relevant.

Almost all users had a need for more than one measure of results. They needed different measures for different analytical purposes. To avoid confusion, users wanted the different measures distinguished by different names and an explanation or reconciliation to show how they are related. Some users in the U.S. wanted it clearly disclosed that the deficit is a result of government policy in that it can be decreased or increased by various changes in policy, such as increasing or decreasing tax revenues and/or expenses.

Following are the measures of results that users indicated would be useful:

□ **Deficit (or surplus) on operations.** Some were interested in the difference between resources becoming available to the government in the year as a result of operations and resources consumed in operations. The term resources is used broadly here. Thus, a claim for taxes arising during the year would represent a resource coming available from operations. But the collection of that claim and subsequent spending of the money on inventory still held at the end of the year would not represent a consumption of resources, because they have merely changed their form. The consumption of resources would be reported subsequently when the inventory was sold or consumed in the course of government operations. In accounting, the inflow of resources is called revenue and the consumption of resources is called expense. The bottom line - the difference between the two - is often called "deficit (or surplus) from operations".

□ **Increase (or decrease) in net debt.** Others are interested in restricting the definition of a resource to cash or assets that represent claims to receive cash. Thus cash spent on inventory for consumption or on buildings and equipment to be used in the government service would be regarded as consumption of resources. In accounting terms, the physical assets would be "written-off" as acquired. Under this basis of accounting, the figure of resource consumption is called "expenditure", not "expense". It is likely that under this basis of accounting, liabilities owing by a government would exceed its recorded resources from operations together with investments so that a net debt position would be shown in the financial statements. The bottom line for a given period on this basis of reporting therefore could be described as "increase (or decrease) in net debt". The deficit that is estimated in Canadian budgets is the forecast increase in net debt in the budgetary period.

□ **Total financial requirements.** Governments acquire resources, such as investments, in non-operating transactions as well as in the course of operations. Expenditures on investments are normally treated as assets, not written off when acquired. But the government must find the money to pay for them. Thus its total financial requirements are affected by purchases and sales of investments as well as the net results of operations. Some users are interested in a figure of "total financial requirements", which can be found by adding net outlays for investments to the figure for increase in net debt from operations.

□ **Borrowing requirement.** Not all the financial requirements of a government must be met by borrowing in the financial markets. A government can draw down its cash balances or use other internal sources of financing. For example, employee pension plans can provide financing in two ways (if the plans are not funded). First, the expense reported by government for pension benefits earned by employees only represents a financial requirement in the more or less distant future. Second, employee contributions to the plan directly reduce the government's external financial requirements if they are directed into the government's cash balances. If total financial requirements are adjusted for such internal financing, one is left with a bottom line that shows the government's "borrowing requirement" for a period. This measure is often described as the "cash deficit" or "cash requirement". It is approximately equivalent to the deficit measure shown in the U.S. budget.

Each of the above four measures may be derived from the accounting basis used in preparing the financial statements in the illustrative Canadian and U.S. Annual Financial Reports. Each of the four is shown in the statement of financial requirements in the illustrative Canadian financial statements.

Users also like to see to what extent deficit, however measured, has been affected by inflation. One way to accomplish this is to present supplementary information in which the impact of inflation is neutralized by reporting in dollars of constant purchasing power. As discussed in a previous section of this chapter, 10-year comparative statements in constant dollars are provided in the illustrative Annual Financial Reports.

Users of the Annual Financial Reports will continue to use information on the federal government obtained from other sources. The main sources are the budget and the National Accounts. To permit the appropriate use of information from these two other sources, users want the Annual Financial Report to include reconciliations between the consolidated deficit on operations and the deficits reported in the budget and the National Accounts. Reconciliations are included in both the U.S. and the Canadian Illustrations.

Asset Valuation

The federal governments in both Canada and the United States frequently provide assistance through the issue of loans on concessionary terms. Assistance loans to developing countries, for example, are often made for a 50-year term, without interest and with no repayment for the first 10 years. Thus, at the date of issue, the amounts advanced considerably exceed the asset value received because of these concessionary terms. The question is whether to account for such loans at the time of their issue at their face value or at a discounted value that would approximate their real or fair value.

Most users wanted concessionary loans accounted for at a discounted value in order to have a clear picture of financial position and a true measure of the cost of aid programs. Some users suggested that loans on highly concessionary terms such as described above could be wholly written off to expense when made, with repayments treated as revenues when received.

In the illustrative Annual Financial Reports, concessionary loans are reported at a discounted value with the grant element of such loans included in expense in the year of issue.

Performance Information

The primary function of a summary Annual Financial Report is as an accountability document showing the performance of the government during the year. The issue of performance information was raised with users to determine what other performance information they needed beyond that already implicit in the discussion of other issues, such as the comparison of budget with actual results.

The overall fiscal performance of the government is shown by measures of deficit such as those discussed in a previous section of this chapter. A number of users indicated that these measures would be more meaningful to them if expressed on a per capita basis or as a percentage of Gross National Product. Government planners and managers suggested that, where budgets included economic or financial targets, the annual report could show performance against the targets.

Many users wanted information on performance at the program level; such measures would help them assess the economy, efficiency and effectiveness of government operations. Users generally agreed that a summary Annual

Financial Report was not the appropriate vehicle for such reporting. Space restrictions in an annual report would require a selectivity in reporting program performance that users felt could result in a biased picture of performance. Users did, however, want references in the annual report to where they could obtain detailed information on program performance.

The illustrative Annual Financial Reports include a discussion up front on overall financial results including selected measures on a per capita basis and as a percentage of Gross National Product. Also included in the Reports are references to where a reader may obtain information on performance at the program level.

Disaggregated Information

This issue refers to the nature of classification and level of detail that users would find useful in a summary Annual Financial Report. The type of analysis for which information can be used depends entirely on how it is disaggregated. For example, analysis of regional effects of resource allocation or regional redistributions implicit in the tax system cannot be carried out without disaggregations of revenues and expenses by region. On the other hand, users cautioned that the summary annual report would be valued just because it was brief and did not get the reader bogged down in details; therefore, excessive detail should be avoided. Users would welcome a list of major sources of detailed information about the federal government.

The illustrative reports provide various classifications at a summary level to give readers a picture of the kinds of information available about the federal government. References to sources of more detailed information are also provided.

Two differences between the Canadian and U.S. Illustrations may be of interest. The Canadian Illustration includes as supplementary information a lengthy schedule setting out expenses and program-related revenues by program. Such information is valued by legislators, policy analysts and other users interested in analysing and commenting on government policy or in assessing the financial implications of possible changes in program delivery. Such a schedule was not considered practical for the U.S. Illustration because of the much larger number of programs in the U.S. system.

The other difference is the display of expense by envelope in the Canadian Illustration. Envelopes are a simplified functional display used for budgeting and resource control purposes in Canada. Most users in Canada want a functional display of expenses, but there is not now a generally accepted definition in use by all levels of government. The envelope display, with the program breakdown referred to above, would probably meet the needs of most users.

Cash and Accrual Information

Federal government budgeting and related reporting of actual results are currently done in the United States on a cash basis and in Canada on a partial accrual basis. An issue often debated in government accounting is whether governments should report on a full accrual basis. Only full accrual provides a measure of the full cost of government operations.

Almost all users wanted accrual accounting for the basic reporting of assets and liabilities and revenues and expenses, as discussed in the previous sections on recognition of physical assets, actuarial liabilities for employee pensions, accrual of tax revenue, and measures of deficit. Most also needed information on cash flows or a reconciliation to show how results on an accrual basis affected the cash position. Such cash information is needed internally for cash control and financial planning and externally for forecasting borrowing requirements and related financial market effects.

A number of users pointed out the complementary nature of cash and accrual information. If the accounts are maintained on an accrual basis, cash and accrual information is available. The statement of financial requirements can be a bridge between the operating results on an accrual basis and the resulting cash or borrowing requirement. Users studied in the U.S. needed a reconciliation between the cash deficit calculated on a budget basis and the accrual deficit reported in the consolidated financial statements.

The Canadian and U.S. Illustrations are both prepared on a full accrual basis. The Canadian Illustration uses the statement of financial requirements to reconcile the deficit on operations to the resulting borrowing requirement. Similar information is presented somewhat differently in the U.S. Illustration. In addition, the U.S. Illustration reconciles the cash flows on a budget basis with the results of operations in the consolidated financial statements.

Chapter Three
The Study Approach and Methods

General Standards for the Study

FGRS was conducted to identify and understand what financial information about the government users need, and for what activities they need it. The answers to these questions, however, had to be linked with specific proposals for the form and content of government financial reports. To achieve this, the following general guidelines for the study were agreed on:

- Since information needs were examined from a user perspective, they should be expressed in the language of the users.
- Information needs expressed should be linked to specific activities of users to ensure a thorough understanding of the needs and to avoid unsupported demands for free information.
- Notwithstanding the user perspective, the answers should be in a form that will facilitate analysis of the technical accounting and presentation issues.

Choice of Approach to the Study

To a considerable extent, the design of the study was dictated by the circumstances. Although the government publishes a wide variety of financial documents, little was known, before the study, about who uses federal government financial information and for what purposes they use it. Thus a statistical sampling approach was ruled out because of lack of knowledge about the universe of users. Inevitably, the study had to be exploratory in nature.

Accordingly, the design of FGRS was not completely specified at the outset. Rather, it was developed iteratively, one phase at a time, so that the design of each phase built on the knowledge gained and advice received in previous phases. At the completion of each phase, the central FGRS Core Group - senior accountants with a background in federal government financial reporting drawn from the Canadian Auditor General's Office and the U.S. Comptroller General's Office - summarized and analyzed the findings for the purpose of making the necessary "course corrections" and developing a sharper focus and more structured methods for the next phase.

The Four Phases of the Study

As it evolved, there were four overall phases to FGRS:

☐ Phase I -	Planning and Organization - December 1983 to June 1984
☐ Phase II -	First Implementation Phase - July 1984 to February 1985
☐ Phase III -	Second Implementation Phase - March 1985 to June 1985
☐ Phase IV -	Analysis and Reporting - July 1985 to March 1986

Phase I: Planning and Organization

Based on the literature, discussions with advisers and the experience of its members, the Core Group agreed to organize the study around six user groups. These groups were:

- legislators;
- citizens, the media, policy analysts, special interest groups and other levels of government;
- government planners and managers;
- economists;
- corporate users; and
- lenders, security dealers, and their advisers.

This organization of users assumed that although the six user groups shared some interests in common, each could be expected to exhibit some group-specific preferences regarding the content and presentation of federal government financial information. It was further assumed that the range of information needs and preferences in the user universe would be captured within the six user groups.

It was agreed that the Canadian and U.S. Core Group members would work jointly on certain aspects of the study and assume different but complementary roles for other experts. In general, the U.S. Group elected to pursue a "top down" and the Canadian Group a "bottom up" approach to their work.

Specifically, the Canadian Group was to begin by having expert representatives of each identified user group explain their activities and needs. This information was later used to develop an illustrative Annual Financial Report. Members of the U.S. Group were to draw on the literature and their own expertise to develop an illustrative Annual Financial Report for subsequent discussion with users.

Jointly, the Core Group identified experts in both countries to serve on an International Advisory Group (IAG) for the study. These 22 advisers included senior government officials, recognized authorities in accounting and auditing, representatives of standard setting groups, and professional accountants practising in the public sector. Toward the end of Phase I, the IAG was convened for the first time and contributed advice on the design for Phase II.

Phase II: First Implementation Phase

Believing the design of a representative sample to be impossible in view of the paucity of information about the universe of users, the Canadian sub-project experts each identified respondents believed to be highly knowledgeable in their respective user group. Information obtained from this prominent subset of users was expected to cover the range of needs and preferences, as appropriate to first-stage exploratory research, where generalisation was not the objective.

The Canadian experts consulted 89 users across the 6 user groups, and an additional 50 citizens in 5 focus group discussions, and prepared reports on the findings for each user group. The U.S. Group and its advisers developed a first draft illustrative U.S. Annual Financial Report, based on their experience during the past several years with the Treasury prototype consolidated financial statements. The illustration also reflected the preliminary Canadian Phase II findings as well as a set of assumptions that had survived internal debate and challenge.

In February 1985, the IAG was convened again to review a presentation of the Canadian and U.S. Groups' work and to advise the Core Group on plans for Phase III.

Phase III: Second Implementation Phase

In Phase II the interviews conducted in Canada had been relatively unstructured because of the desire to probe for information. In Phase III, structure was added to allow Canadian and U.S. interview teams to test the Phase II findings and to ensure that all respondents were expressing their opinions and preferences with respect to identified issues. This structure was achieved in two ways:

- Sixteen major questions were identified from the findings of the Phase II interviews. These were focused on information that could be presented in a summary-level Annual Financial Report.
- The Canadian group drafted an illustrative Annual Financial Report designed to satisfy as many as possible of the information needs identified in Phase II.

At the Phase III interviews, all respondents were asked to express an opinion on the potential usefulness of an Annual Financial Report such as was illustrated and to react to the questions on the other 15 issues.

In all, 131 users were consulted in Canada and 125 in the U.S. during Phase III.

At the end of Phase III, the IAG convened in a final meeting with the Core Group to analyse findings and discuss reporting themes and formats. Discussion focused on the 16 key questions that had provided the structure for Phase III.

Phase IV: Analysis and Reporting

The foundation of the final report consisted of draft reports by each of the experts responsible for the Canadian user group interview program. U.S. findings were integrated with these draft reports to produce draft chapters, each chapter covering a group of users. The Core Group drafted summary chapters and a revised illustrative Annual Financial Report for each country, based on the findings in the integrated chapters on individual user groups. The complete work, including summary and user group chapters and revised Illustrations, was given a final review by the experts responsible for the Canadian interview program and by members of the IAG.

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Statement of
Rudolph G. Penner
Director
Congressional Budget Office

before the
Committee on Governmental Affairs
United States Senate

May 13, 1986

NOTICE

This statement is not available for public release until it is delivered on Tuesday, May 13, 1986.

Mr. Chairman, I am pleased to have this opportunity to present the views of the Congressional Budget Office (CBO) on the budgetary treatment of federal credit programs. I will make three points in my statement:

- First, the current budgetary treatment of federal credit assistance fails to depict accurately the costs to government of current activity. More precisely, current budget treatment focuses on the first-year financing costs rather than long-run subsidy cost. Budget accounting for credit is also susceptible to manipulation, by which I mean that one can favorably affect budget cost by changing the names and form rather than the substance of particular credit programs.

- Second, most observers agree that in order to capture the relevant costs and to prevent manipulation of the budget numbers for credit assistance, subsidy costs should be substituted for program financing costs in the budget documents.

- Third, several means exist to accomplish this change, and I wish to note some of the advantages of each.

DEFICIENCIES IN THE CURRENT BUDGETARY TREATMENT

Time is an essential feature of a credit transaction. Usually, credit involves an exchange of money now for a promise (sometimes conditional) of money later. By definition, an annual cash-based budget like ours is going to have difficulty accounting for multi-year credit transactions. Consider three hypothetical examples:

- The government lends $100 for 10 years. It has exchanged cash now for a promise to pay principal and interest in the future. The cash-based budget shows this as an outlay of $100 in year one, or the same as the reported cost of a grant of $100. This method of accounting overstates the cost of the loan to the government.

- The government receives a payment of $100 from a loan made 10 years earlier. In the cash-based budget, this payment is shown as a negative outlay of $100. If the receiving agency relends the $100, reported net outlay costs will be zero. The new loan thus appears to be costless.

- The government agrees to guarantee $100 of private debt. The cash-based budget records no cost for this commitment until the commitment has to be honored

> with an outlay. This understates the cost of the assistance at the point when the commitment becomes binding on government.

In each of these cases, the budget accurately records the effect of the transaction on government's current financing requirements: +$100 in the case of the loan disbursement; -$100 in the case of the loan repayment; zero in the case of the guarantee. But the real cost to government over the long run will depend on a number of factors not reflected in the financing requirement. These factors inlude the interest rate and guarantee fees charged, government's cost of money, expectations of default, and the value of collateral.

The inadequacies of using current financing requirements as a proxy for credit costs have been recognized for years. But the pressures to misstate true long-run governmental costs are greater now than before because of constraint on the unified budget deficit by the Balanced Budget and Deficit Control Act of 1985. For credit programs, this constraint has created an incentive to substitute programs with low first-year or off-budget financing requirements for high first-year on-budget financing, without reducing the real cost to the government and without changing the substance of the program.

Proposals have been offered recently, for example, to convert direct loans into equivalent guaranteed loans; to sell loans to private investors with recourse and other types of guarantees; to switch borrowers with 100 percent federal guarantees from the Federal Financing Bank (FFB) to private lenders; and to convert agency debt into agency "equity". These types of budget manipulation are possible because the budget focuses on the financing costs of credit assistance rather than the subsidy cost.

SUBSTITUTING SUBSIDY COST FOR FINANCING REQUIREMENTS

If individual credit programs were charged in the budget for the subsidy conveyed rather than for current financing requirements, the budget would permit comparisons between the real cost of credit and the cost of other forms of assistance, including grants. Moreover, such a change would transform the incentive to reduce first-year financing requirements into an incentive to reduce true, long-term subsidy costs.

The subsidy cost of a credit transaction is the net, long-term loss to the government on the transaction. Suppose, for example, that the government advances $100 in exchange for a promise to pay that amount. Suppose also that, because of the low interest rate charged, the substantial administrative costs of debt service and collection, and the high probability of default, the loan has a private market value of only $65. In that case, the loss or subsidy cost to government is $35, and the substitution of true subsidy cost for first-year financing requirements would reduce the reported cost of the loan in the budget from $100 to $35.

For guarantees, the actuarial value of insurance provided by the government could be $100 for which government might charge no fee. If so, the subsidy cost of the guarantee is $100. Substituting subsidy cost for financing requirements in the case of guarantees will raise the reported first-year cost of guarantees, and in this particular case, the reported cost would rise from $0 to $100.

The Office of Management and Budget (OMB) estimates that the subsidy cost for federal direct loans obligated and guarantee commitments extended in 1985 was about $16 billion compared with a financing requirement cost of $28 billion. The financing requirement, therefore, exceeded 1985 credit subsidy cost by $12 billion. For 1984, OMB estimates that subsidy costs were about $15.7 billion compared with the financing requirement cost of $6.3 billion. Thus, credit costs were understated by $9.4 billion in 1984.

PROPOSED SOLUTIONS

Having gone to some lengths to point out the current failings of the cash-based unified budget in treating credit transactions, I wish to emphasize that I regard the retention of such a budget as indispensible. The Congress, the Treasury, and the public need to know the overall magnitude of the government's fiscal operations as well as how this activity is financed. Fortunately, the major proposals for substituting subsidy cost for financing requirements are fully consistent with a cash-based, unified budget.

The Market Plan

S.2142 would preserve the comprehensiveness and cash basis of the unified budget and substitute subsidy cost for financing requirements by the competitive sale to the public, without recourse or other guarantees, of newly originated loan assets. Such sales would produce a market valuation of the asset acquired by government in exchange for a cash disbursement. In addition, these sales would generate offsetting receipts, which when netted from amounts disbursed would yield an exact measure of both subsidy costs and government financing requirements. Thus, the Market Plan substitutes subsidy costs for financing requirements by forcing the subsidy and only the subsidy to be financed. All subsidies would be charged to credit agencies, which would require appropriations to finance them.

To address the understatement of guarantee cost and avoid creating an incentive for the conversion of all direct loan programs into guarantees, S.2142 could also require the reinsurance of all guarantees with private entities. By this means, the Market Plan would force the subsidy cost of guarantees to be financed. This option would work efficiently only if a competitive private reinsurance market evolved quickly. To the extent that development is expected to lag, some phase-in may be necessary. Moreover, a few areas may exist in which a market might not develop at all because private insurers may encounter considerable difficulty in identifying risks and in diversifying these risks.

The Market Plan is the most direct means of accounting for subsidized credit transactions in a cash-based budget. It achieves the desired objective of recognizing the amount of government assistance provided by means of a competitive sale of the assets acquired and reinsurance of risks. The Market Plan also minimizes the government's cost of assigning values to assets and liabilities. Further, the Market Plan provides (through a desire to maximize loan sale prices and to minimize reinsurance costs) keen incentives for standardizing credit contracts and improving record keeping for loans and guarantees.

Standardized loan agreements and improved record keeping are essential to the development of secondary markets for government-originated loans. Such markets reduce interest costs by reducing liquidity risks. Where secondary markets are slow to develop, some transition may be useful in assuring that government receives the best possible price for these loans.

The Appropriations Plan

This approach was taken in the recently introduced S. 2428 and separates subsidy costs from first-year financing requirements. It would do so by consolidating all separate revolving funds into one central, actuarially-sound revolving fund for credit activities within the Department of Treasury. All direct loan disbursements and guarantee payments would be charged to this fund. Similarly, all loan repayments and fees would be credited to this fund. Existing credit agencies would continue to operate the credit programs, but they would be required to pay (with appropriated funds) the subsidy costs of these activities to the central loan fund. As with the Market Plan, these subsidy cost payments would be shown in the budget as outlays of the credit agencies. The residual unsubsidized financing requirements would be charged to the revolving fund rather than to the credit agency.

A crucial element in the success of the Appropriations Plan will be the ability of the central loan fund to assess the value of various credit instruments accurately and at reasonable costs. The fund staff would be greatly aided in this effort by the sale of some loans and the commercial reinsurance of some credit risks. Over time, as market acceptance increased, the loan fund might increase the proportions of loan assets sold and guarantees reinsured. In this manner, the Appropriations Plan could provide a transition vehicle to the Market Plan.

CONCLUSION

The current budgetary treatment of federal credit assistance is inadequate in that it fails to provide the Congress and others with a timely measure of the real cost of current activity. As the nature of this failure has become more apparent and budgetary pressures more intense, it has become increasingly difficult to avoid exploiting this failure. Both the Market and Appropriation Plans provide a solution through the substitution of subsidy costs for current financing costs. The choice between these proposals probably hinges on one's relative confidence in market and nonmarket pricing mechanisms and the speed with which one believes the market can adjust to these new financial instruments.

STATEMENT OF JOSEPH E. CONNOR
CHAIRMAN AND SENIOR PARTNER
PRICE WATERHOUSE

IN ASSOCIATION WITH
CITIZENS AGAINST GOVERNMENT WASTE

CONCERNING

S.2230

FINANCIAL MANAGEMENT REORGANIZATION AND COST CONTROL ACT

SENATE COMMITTEE ON GOVERNMENTAL AFFAIRS
MAY 13, 1986

STATEMENT OF JOSEPH E. CONNOR
S.2230

Mr. Chairman, my name is Joseph E. Connor. I am the Chairman and Senior Partner of the United States firm of Price Waterhouse. I am here today to present my views on S.2230 from the perspective of my firm's long-time concern with federal government management improvement and my own involvement in the President's Private Sector Survey on Cost Control--the Grace Commission. I was privileged to serve as the co-chairman of the Commission's Task Force on Federal Management Systems.

Accompanying me are Mr. George Goldberger, Executive Director of Citizens Against Government Waste, a non-profit foundation working to implement the Grace Commission's recommendations, and Edward J. Haller, my partner who worked with me on financial management issues for the Task Force.

The Grace Commission's charge was to identify areas in the federal government where management improvements and cost savings could be achieved through the application of the most advanced techniques and solutions available from the private sector. Working from June 1982 to the end of 1983, the Commission produced 47 separate reports containing 2,478 recommendations.

Mr. Chairman, our paths have crossed repeatedly, and I always find you in a leadership position. You led the effort to enact the Federal Managers' Financial Integrity Act. You pioneered the concept of a Presidential Management Report. You have been instrumental in ensuring that the management improvement recommendations of the Grace Commission do not gather dust on some obscure shelf.

Now you are taking the initiative in developing legislation to address a crucial structural flaw which the Federal Management Systems Task Force found in the organization of the Executive Branch--that is, the absence of effective leadership in financial and administrative management of the federal government.

I wholeheartedly support the overall management improvement objectives of S.2230, and I commend you for addressing this management leadership void. At the same time, I believe that the bill, in its current form, falls short in achieving two fundamental objectives which are critical to substantive improvement of Executive Branch financial and administrative management:

- First, appropriate integration of the federal government's currently fragmented and isolated financial and administrative management functions; and
- Second, the provision of adequate organizational stature and authority for the financial management function.

Let me briefly discuss each of these points.

Integration of Functions and Organizations

I view integration from two perspectives.

First, there is the need for horizontal integration--or the functional interrelationship, if you will--between the existing budgeting, financial management and other administrative management activities.

Second, there is the need to strengthen vertical integration by providing a clear delineation of management responsibilities within functional areas, as reflected by the authorities and responsibilities that flow between the central agencies and executive branch agencies.

To illustrate what I mean, let me refer to the Report of the Grace Commission's Task Force on Federal Management Systems and our recommended version of an Office of Federal Management.

The Task Force found little effective integration, from either a functional or an organizational standpoint. What we found instead was that responsibilities for financial management and administrative management were distributed among many organizational units.

This fragmentation resulted in unclear and often overlapping responsibilities; major responsibility gaps; unclear relationships between the central agencies--that is, OMB, Treasury, GSA, and OPM--and their counterparts in the executive agencies; and a resulting inability to effectively implement major financial or administrative improvements.

Most significantly, there was no real integration between budgeting and financial management because, although some financial management functions were present in OMB, they had been generally relegated to a secondary role compared to budgeting. You could say the same about OMB's administrative management activities. In short, the "M" in OMB was muted.

In order to provide for the functional and organizational integration of the government's budgeting, financial management and other administrative management functions, the Task Force proposed the establishment of an Office of Federal Management with the following attributes. For convenience, please refer to Exhibit A, page 19 of our statement.

- Overall leadership and policy guidance would be provided by a Director of the Office of Federal Management, reporting directly to the President.
- The OFM would be composed of five functional organizational units with clearly-defined responsibilities. Those units were: budgeting and planning, financial management, human resources, administrative services, and management improvement.
- Each functional area would have a designated head.
- The OFM would oversee a coordinated administrative structure in which GSA and OPM assume a direct reporting relationship to the OFM, and clear working relationships were established with functional counterparts in the executive agencies.

Well-defined functional responsibilities on a common organizational level, effective leadership with the authority to coordinate operations and decisionmaking, and clearly defined working relationships with line agency counterparts--these are the key ingredients of the Grace Commission's Office of Federal Management.

The Office of Federal Management proposed in S.2230 clearly lacks certain of these attributes. For the sake of brevity, let me provide some examples. Please refer to Exhibit B on page 20 of our statement.

First, in the area of functional integration, the budgeting function has been completely detached from all other financial and administrative management counterparts. Morever, it resides on a different organizational level from the function with which it should have the closest association--financial management.

Second, in the area of organizational integration, not only has budgeting been functionally separated from all other management areas, but the bill has no explicit provision for interaction or consultation between the proposed Office of Financial Systems and the Office of Federal Budget on matters of common concern.

And third, the Director of the Office of Federal Management has been assigned certain responsibilities in the area of human resources, which falls generally under the jurisdiction of the Office of Personnel Management (OPM), and in the areas of property and travel management, which fall largely under the jurisdiction of GSA. Yet no explicit cohesive working or reporting relationship with these agencies is spelled out.

Organization and Authority of Financial Management

Before I turn to financial management, the other principal shortcoming of S.2230, let me comment on the importance of financial management as reflected by the findings of the Task Force, as well as my own professional experience and convictions.

What function of the federal government consistently commands the most attention? The answer is easy, especially with Gramm-Rudman constantly in the headlines. It is of course the budget function. It affects our pocketbooks, our jobs, the services we receive or do without. It affects taxation because it dictates how much the government will require from taxpayers to support its operations. And where is taxation at the moment, Mr. Chairman? It is in the headlines, thanks to the activities of the Senate Finance Committee, of which you are a leading member.

Yet, with all the importance accorded to budgeting, we have the following state of affairs:

- Budget decisions are based on unreliable and incompatible information produced by antiquated and substandard accounting systems. The Comptroller General has expressed grave concern about using such information to implement Gramm-Rudman.
- Lack of integration between budgeting and accounting systems means that budgeted amounts cannot be tracked through the system to (1) ensure that they were spent for the designated purpose or (2) furnish a basis for a decision as to whether more, less or nothing will be required for the purpose the following year.
- Resources and assets are not adequately safeguarded against waste.
- There is almost no way of adequately evaluating performance to ensure that resources are expended with maximum efficiency for maximum benefit.

Mr. Chairman, these are not budget issues, these are accounting and financial management issues.

When the Federal Systems Task Force studied the organization and authority of financial management, it found two major deficiencies:

- Financial management responsibilities were fragmented;
- Financial management activities were not accorded the same organizational stature and authority as budgeting, even though they represent, if you will, the flip side of the fiscal coin. How can budgeting be anything but a dangerous guessing game without reliable financial information on which to base decisions?

S.2230 goes part of the way towards solving the problems. It attempts--not entirely successfully--to address fragmentation. But it does not recognize the equivalent importance of budgeting and financial managment.

More specifically, with respect to the proposed Office of Financial Systems and its leadership as provided by the proposed Administrator, we believe that S.2230 does not provide assurances that the following objectives necessary to an effective financial management function will be achieved:

- First, organizational parity. By reducing the significance of the financial management function, as demonstrated by the uneven organizational relationship between the Office of Federal Budget and the Office of Financial Systems, S.2230 encourages perpetuation of the current environment in which actual results of operations and costs of managing the government are not appropriately considered in the decisionmaking process.

  For this reason, we would urge your most serious reconsideration of the necessity of maintaining the organizational parity between these two functions, as recommended in the Grace Report and demonstrated in Exhibit A.

- Second, sustained and qualified leadership. The bill proposes a term of office for the Administrator of only four years, a period of time which is inadequate to implement the complex, long-term improvements required to achieve an acceptable level of financial management.

  Neither is the compensation level commensurate with the responsibilities and challenges assigned to the Administrator of the Office of Financial Systems.

  To correct these deficiencies, the term of office and compensation level accorded the Administrator position should be equivalent to those accorded the Comptroller General of the United States, since we believe that the duties and responsibilities of the two offices are comparable.

- Third, compliance with management objectives. The absence of more than a budget review privilege accorded the Administrator precludes his ability to assure that funds being expended by a department or agency are in harmony with government-wide financial management objectives and recognized agency requirements.

  This weakness can be corrected by granting the Administrator approval as well as advisory authority over agency financial management budgets, subject only to the subsequent concurrence of the Office of the Federal Budget.

- Fourth, effective decisionmaking. The bill frequently perpetuates the current inappropriate pattern of divided and overlapping distribution of financial management responsibilities among the Comptroller General, the Secretary of the Treasury and the Administrator.

  This is perhaps the most serious flaw in current procedures which is not corrected by S.2230. It should be remedied by granting the Administrator sole responsibility to issue financial management policy and procedural requirements consistent with the accounting standards promulgated by the Comptroller General and the budgetary requirements of the Director of the Federal Budget.

- And fifth, system discipline. While agency controllers are appropriately established to execute agency and government-wide plans, the Administrator has no effective means to remedy their inadequate performance and assure their timely attention to priority issues.

  The Administrator should be granted approval authority over the selection and removal of agency controllers. Agency controllers should be granted similar authority over bureau controllers.

In addition to the previous recommendations which relate to the organization and structure of authorities, we have several other recommendations regarding changes in specific provisions of S.2230 which we believe are essential to a sound financial management process. They include:

- First, independent audits. The bill provides for biennial independent audits of the financial statements of departments and agencies and annual audits of government corporations. It also stipulates that agency audits may be performed by Inspectors General or "an internal auditor of the executive agency who is independent..."

  Audit requirements for departments and agencies should parallel those adopted for government corporations. We are unaware of any justification for variations in the frequency of audits. Additionally, the existing criteria of the Comptroller General for establishing the independence of auditors appear to provide adequate guidance for the selection of auditors. Reference in the bill should be to the applicability of those criteria.

- And second, the establishment of agency controllers. The bill specifies a list of agencies which are to have controllers. The basis for the list appears to be that small agencies do not require such a position. We believe this is not the most desirable standard to apply. Controllers should be designated for all governmental units which maintain accounting records. The importance of controllership responsibilities does

> not vary with the size of the organization. This fundamental management control is required by all organizations which conduct an accounting activity.

Expansion of Financial Management Recommendations

The following comments are provided as additional support for our recommendations concerning the financial management function.

Organizational Parity

Budgeting and accounting are inexorably intertwined. The former deals with planning for fiscal expenditures and the latter the reporting of the actual results of those plans. From a control or check-and-balance perspective, the budget activity should never be placed in an organizational position that permits it to manage, or to intentionally or unintentionally influence how actual results are accounted for and reported. It is for this reason that budget activities are usually placed either within the financial management organization, or in parity with it--but never in a position of organizational supremacy.

I would also suggest that close attention be given to the organizational balance struck between the financial and audit functions of an organization--in these circumstances the Administrator of the Office of Financial Systems and the Comptroller General. There is no question that the Comptroller General's reporting relationship to the Board of Directors, in this case Congress, must be preserved. However, the unique powers granted the Comptroller General in this case to establish accounting principles, as established by the Budget and

Accounting Act, requires an organizational counterbalance in the Executive Branch. The Administrator of the Office of Federal Systems must be granted the organizational strength and stature to challenge those principles when deemed appropriate.

And speaking of parity we also consider it appropriate that the Administrator, whom we would prefer to be described as the Chief Financial Officer, be considered the Executive Branch counterpart of the Comptroller General with regard to financial matters. Together they administer the financial management and audit activities of the federal government. I will save for another day my recommendation that the present Comptroller General relinquish his title to the Director of the Office of Financial Management and henceforth be known as the Auditor General.

Tenure

The problems which beset the financial management structure of the federal government require long-term solutions, not a quick fix. This has been recognized for many years. However, what has not been accepted is that long-term remedies require management consistency. If they are to be successful, multi-year projects cannot be interrupted by frequent leadership and priority changes. This has been the cause of the lack of progress to date. Furthermore, financial management should be perceived as apolitical. If the proposed legislative solution is to have a meaningful impact on the financial management environment, it is important that the participants recognize that goals and objectives will not be easily discarded once they are adopted. The effective track record of the General Accounting

Office is in large measure, we believe, attributable to consistent leadership.

Compensation

If this legislation is intended to seriously address the existing weaknesses in the government financial management structure, there must also be a recognition that it will be a complex and difficult task. I assure you, it is not exaggeration to say that the job that must be done is of unparalleled scope and magnitude. And as a result the management skills required of the Administrator must be equal to the task. To attract a qualified individual to this position the compensation must be competitive with private sector counterparts and commensurate with the responsibilities assumed and the expectations of the Congress. These appear to be precisely the challenges which were present when the position of Comptroller General was created. Accordingly, we believe a compensation plan for the Administrator of the Office of Financial Systems comparable to that of the Comptroller General would be appropriate.

Authority

It is a fundamental premise of management that if individuals are expected to be effective, their authority must be equivalent to the responsibility that is placed upon them. To charge the Administrator with the responsibility for the functioning of the federal government's financial management systems, consisting principally of separate departmental and agency systems, without providing adequate authority over the development and management of those systems is unrealistic. Authority in this case takes the form of policy implementation, personnel supervision, and budgetary approval, each of which is discussed briefly below.

Policy Implementation: We have previously noted that this legislation in some respects creates further duplications, conflicts and blurred lines of authority in a system already moving at a snail's pace. When authority for establishing policy and procedures is shared, the resulting guidance is often conflicting, inconsistent and inadequate. While we would of course expect the Administrator of the Office of Financial Systems to seek appropriate consultation, he should ultimately be responsible for decisionmaking. The consultation we refer to was provided for in the Grace Report in the form of an interagency President's Council on Financial Management, consisting of the controllers of the principal executive agencies and chaired by the Chief Financial Officer.

Personnel: The current financial management system is plagued by three very significant personnel weaknesses: no focus of financial management responsibility at the central agency level; ineffective communication and monitoring of activities between the central agencies and executive departments and agencies; and little effective control of department controllers over their respective bureau controllers. Hampered by so many missing links it is a wonder that the system has survived. We give credit for this survival to the many dedicated financial management professionals who are crying out for leadership. That need was repeatedly expressed by respondents to a survey of government financial management executives performed by Price Waterhouse for the Systems Committee of the President's Council on Management Improvement. A copy of that report is submitted for the record of the hearing.

The establishment of the Office of Financial Systems solves the central focus of responsibility issue. A cure for the remaining weaknesses lies in restoring the missing links in the chain of command by ensuring that department and agency controllers recognize their responsibilities to the Office of Financial Systems. This we believe is effectively accomplished by providing that departmental and agency controllers will be appointed and removed only with the consent of the Administrator of the Office of Financial Systems.

Budget Approval: No discussion of authority in government would be complete without a discussion of budgetary authority. To paraphrase a famous saying, "He who has the gold makes the rules." To date departments and agencies have dealt unilaterally with the Office of Management and Budget on all budgetary matters, including the financial management aspects of their budgets. However, from time to time certain areas of expenditure have been singled out for special government-wide attention because it has been believed that by doing so, greater economy and efficiency is achieved. Examples include computer, building, and supplies acquisition.

We believe it is timely to think of financial management in a similar manner. If we are to achieve economy and efficiency in government-wide financial management we must begin thinking of financial management budgeting on a government-wide basis. If the Administrator of the Office of Financial Systems is to develop and monitor plans for systems development, isn't it logical that he have a strong voice in how those budget resources are allocated? We obviously think so. The Administrator must have authority over agency financial management budgets to assure that funds are being expended in harmony with government-wide financial management objectives and identified agency needs.

Alternative Proposal

Mr. Chairman, I realize that in developing your proposal for an Office of Federal Management, you consulted many sources and voices, of which the Grace Commission was only one. But I believe that in many respects the model for an Office of Federal Management contained in the Grace Commission's Federal Management Systems Task Force report would produce more effective results than the model proposed in S.2230. It would achieve functional and organizational integration of budgeting, administrative management, and financial management functions. And it accords financial management appropriate organizational parity and authority.

In urging reconsideration of the Grace Commission model, I recognize that some concerns have been expressed about its practicality, especially in political terms. For example, I understand that a principal objection is that it would place an intermediary between the budget function and the President.

In order to address that objection, let me propose for your consideration an alternative organization plan for the budget, financial management and administrative management functions. While not a recommendation of the Grace Commission, I offer it on behalf of Price Waterhouse in the spirit of cooperation and dedication to remedying a serious flaw in the proposed bill's management structure.

The Office of Federal Management was interposed between the line central management functions and the President because the five primary areas of functional activity were thought to create too wide a span of control for the President to directly accommodate.

By consolidating three of these activities into a single Office of Administrative Management we could reduce span of control. Please refer to Exhibit C on page 21. What results is an Office of the Federal Budget, an Office of Administrative Management, and an Office of Financial Management, each headed by a Director, in the Executive Office of the President.

For the sake of simplicity, we assigned responsibilities to each of these three offices along the lines proposed in the Grace model:

- o The Office of Budget would have those responsibilities which fall under the budget and planning function;
- o The Office of Administration would encompass those responsibilities related to management improvement, human resources, and administration;
- o The Office of Financial Management would logically assume the responsibilities assigned to the financial management function.

Details of the assignment of responsibilities can of course be worked out. There may be other specific duties which you feel should be assigned to one of these three Offices--keeping in mind the desirability of a clear and logical delineation of responsibilities.

The important result is that this alternative structure would accomplish the following objectives:

- It would remove the need for the intermediate layer between all of the principal management functions and the President.
- It would place budgeting, administrative management, and financial management in a position of organizational parity.
- It would place ultimate responsibility for integration and coordination of these three functions at the highest possible level--the Chief Executive Officer.

Some have claimed that the wholesale reorganization of the federal government's budget and management functions--whatever form it may take--is far too ambitious. They say, it will never happen. You may reach the same conclusion after hearing the myriad and possibly conflicting views presented in these and other hearings.

Let me leave you with this thought--a plea, actually, from a long-time student and I hope constructive critic of federal government financial management. If nothing else is done in the management area, Congress and the Executive Branch should take the steps necessary to strengthen the financial management function and institutionalize it at the same organizational level as the budget function.

It's not only the right time to do it, but with Gramm-Rudman staring us in the face, it's long past due. The Comptroller General tells us that antiquated and incompatible accounting systems cannot provide the information needed to make reliable decisions under Gramm-Rudman. Our taxpayers tell us they don't like having their services cut when wasteful mismanagement of resources is allowed to go unchecked. Your Committee can provide the solution to this problem. I urge you to consider doing so, if you do nothing else.

Mr. Chairman, that concludes my prepared statement. Again, I commend you and the members of this Committee for the leadership you have shown in constantly seeking ways to bring sound management to the affairs of the Federal government.

ORGANIZATIONAL CHART - GRACE COMMISSION

EXHIBIT A

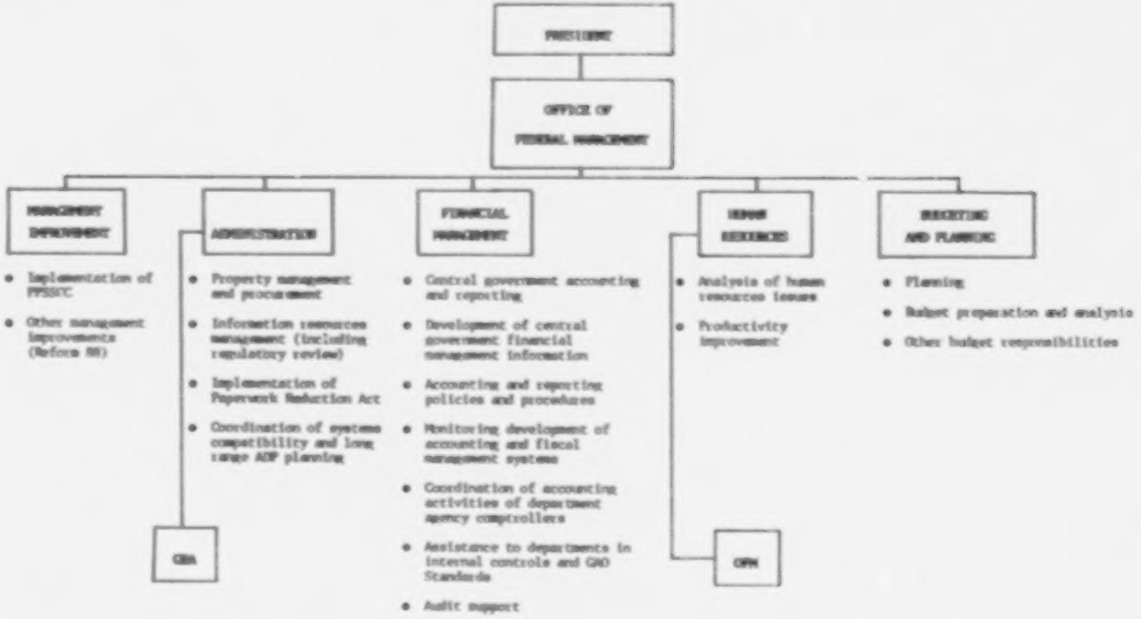
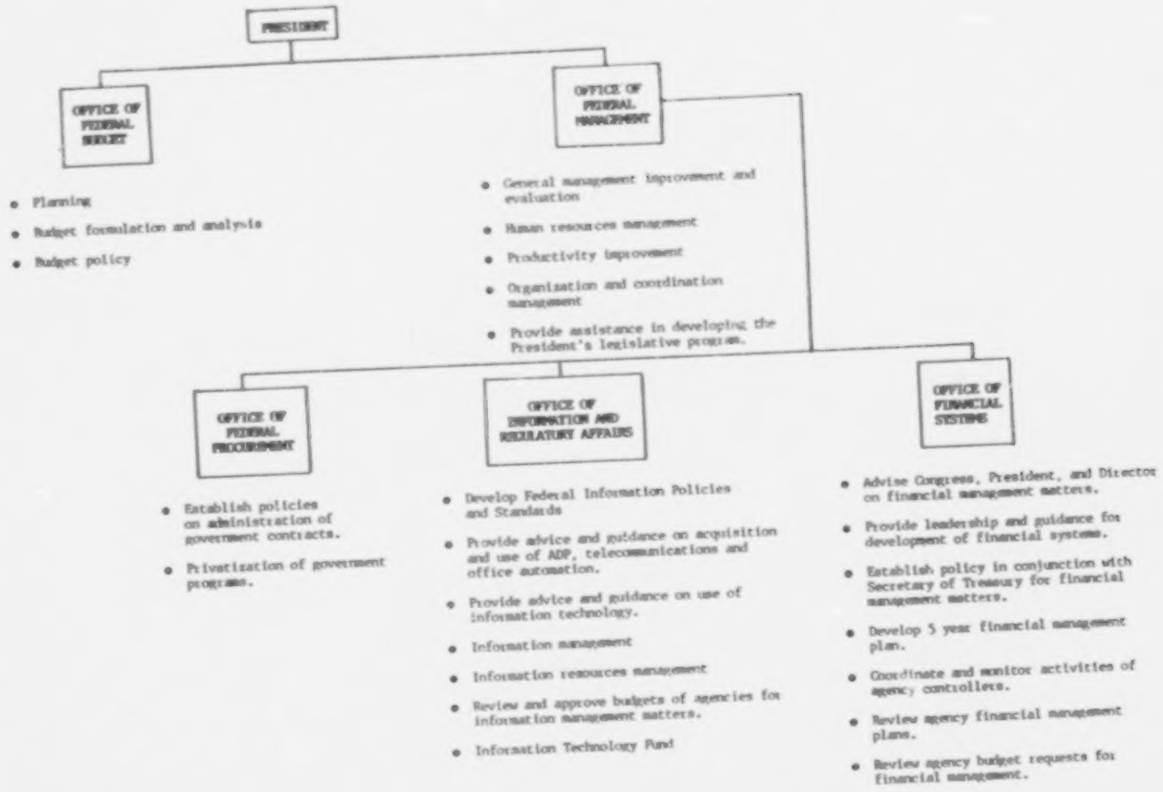

PRESIDENT
OFFICE OF FEDERAL MANAGEMENT
MANAGEMENT IMPROVEMENT
• Implementation of PPSSCC
• Other management improvements (Reform 88)
ADMINISTRATION
• Property management and procurement
• Information resources management (including regulatory review)
• Implementation of Paperwork Reduction Act
• Coordination of systems compatibility and long range ADP planning
GSA
FINANCIAL MANAGEMENT
• Central government accounting and reporting
• Development of central government financial management information
• Accounting and reporting policies and procedures
• Monitoring development of accounting and fiscal management systems
• Coordination of accounting activities of department agency comptrollers
• Assistance to departments in internal controls and GAO Standards
• Audit support
HUMAN RESOURCES
• Analysis of human resources issues
• Productivity improvement
OPM
BUDGETING AND PLANNING
• Planning
• Budget preparation and analysis
• Other budget responsibilities

EXHIBIT B

ORGANIZATION CHART REFLECTING S 2230


PRESIDENT
OFFICE OF FEDERAL BUDGET
OFFICE OF FEDERAL MANAGEMENT
OFFICE OF FEDERAL PROCUREMENT
OFFICE OF INFORMATION AND REGULATORY AFFAIRS
OFFICE OF FINANCIAL SYSTEMS

- Planning
- Budget formulation and analysis
- Budget policy

- General management improvement and evaluation
- Human resources management
- Productivity improvement
- Organization and coordination management
- Provide assistance in developing the President's legislative program.

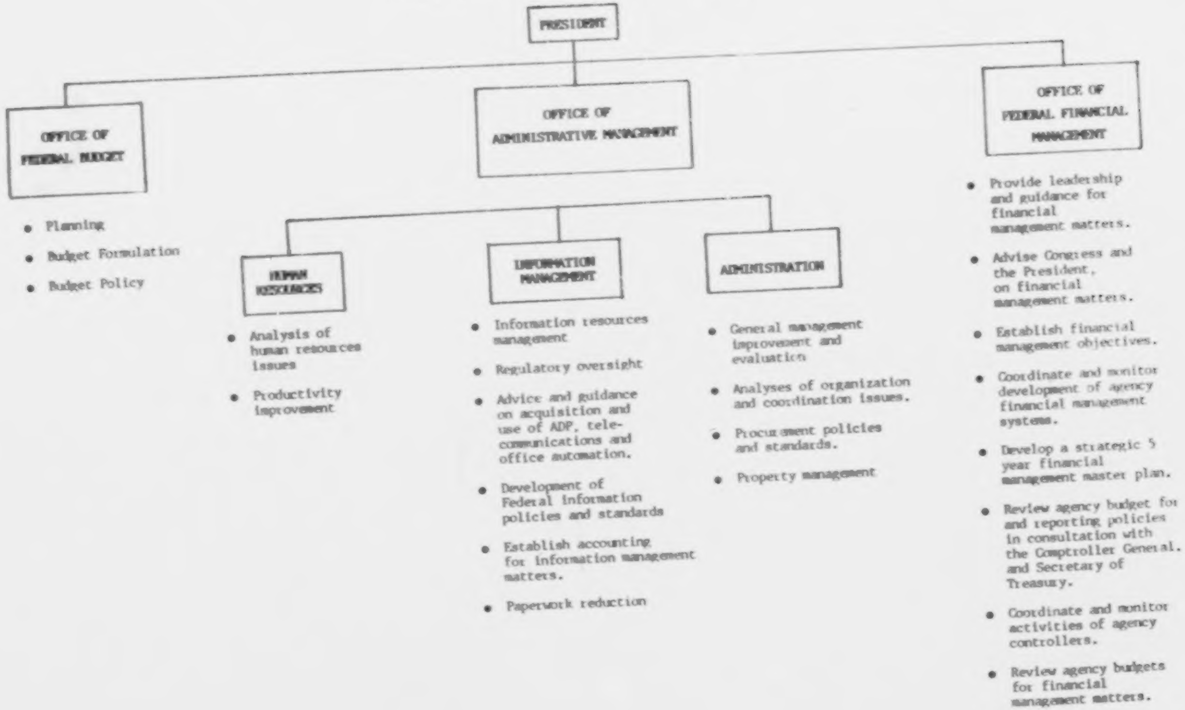
- Establish policies on administration of government contracts.
- Privatization of government programs.

- Develop Federal Information Policies and Standards
- Provide advice and guidance on acquisition and use of ADP, telecommunications and office automation.
- Provide advice and guidance on use of information technology.
- Information management
- Information resources management
- Review and approve budgets of agencies for information management matters.
- Information Technology Fund

- Advise Congress, President, and Director on financial management matters.
- Provide leadership and guidance for development of financial systems.
- Establish policy in conjunction with Secretary of Treasury for financial management matters.
- Develop 5 year financial management plan.
- Coordinate and monitor activities of agency controllers.
- Review agency financial management plans.
- Review agency budget requests for financial management.

EXHIBIT C

ORGANIZATION CHART--PROPOSED ALTERNATIVE


PRESIDENT
OFFICE OF FEDERAL BUDGET
Planning
Budget Formulation
Budget Policy
OFFICE OF ADMINISTRATIVE MANAGEMENT
HUMAN RESOURCES
Analysis of human resources issues
Productivity improvement
INFORMATION MANAGEMENT
Information resources management
Regulatory oversight
Advice and guidance on acquisition and use of ADP, tele-communications and office automation.
Development of Federal information policies and standards
Establish accounting for information management matters.
Paperwork reduction
ADMINISTRATION
General management improvement and evaluation
Analyses of organization and coordination issues.
Procurement policies and standards.
Property management
OFFICE OF FEDERAL FINANCIAL MANAGEMENT
Provide leadership and guidance for financial management matters.
Advise Congress and the President, on financial management matters.
Establish financial management objectives.
Coordinate and monitor development of agency financial management systems.
Develop a strategic 5 year financial management master plan.
Review agency budget for and reporting policies in consultation with the Comptroller General. and Secretary of Treasury.
Coordinate and monitor activities of agency controllers.
Review agency budgets for financial management matters.

Statement of George S. Goldberger

President-Designate

Citizens Against Government Waste

Before the Senate Committee on Governmental Affairs

on S. 2230,

Federal Management Reorganization and Cost Control Act of 1986

May 13, 1986

Mr. Chairman, members of the Committee, thank you for the opportunity to appear before you today to discuss S. 2230, Federal Management Reorganization and Cost Control Act of 1986. Mr. Chairman, you and your staff are to be congratulated for the extensive work you have done on management reform and for producing a critically important piece of legislation.

I am appearing today with Joseph E. Connor and Edward J. Haller of Price Waterhouse and John V. Grobowski of Citizens Against Government Waste (CAGW) on behalf of CAGW. CAGW is a non-profit foundation which for the past two years has been educating the American people about the recommendations of the President's Private Sector Survey on Cost Control (PPSS), popularly known as the Grace Commission, and other cost-saving proposals. Acting in an informational capacity, CAGW works closely with Associations United to Cut Federal Spending, composed of 61 associations representing over 9.8 million individuals and 672,000 companies, and the Senate and House Grace Caucuses, currently composed of 28 Senators and 115 Representatives, to reduce waste and inefficiency in government spending.

The Grace Commission was established by President Reagan in 1982 to study Federal Government operations and suggest initiatives to allow the government to run more efficiently and at less cost to the taxpayer. The Grace Commission report contained 2,478 recommendations with the potential to save $424.4 billion in the three years following full implementation. The Office of Management and Budget (OMB) reported in February 1986 that 596 recommendations have been implemented to date. OMB also stated in its FY 1987 management report that $30.6 billion in savings from Grace Commission recommendations is included in the fiscal year 1986 budget baseline.

These are all positive developments in fighting government waste. But, more needs to be done.

Federal Government management reorganization is one of the most fundamental and vital initiatives to improve government efficiency. Without a proper framework and guidance, the federal system cannot determine how to properly allocate its resources.

There are three PPSS task force reports related to S. 2230. They are the reports on Federal Management Systems, Financial Asset Management, and Automated Data Processing (ADP)/Office Automation.

The PPSS Task Force on Federal Management Systems studied and discovered serious structural problems in Executive branch management processes, organization, financial management, information flow, budgeting, planning and evaluation procedures, communication practices, and continuity of management. These management shortcomings are reiterated throughout the 47 PPSS Task Force reports.

Management weaknesses in the Executive branch identified by the Federal Management Systems Task Force include the following:

In the area of management organization:

- Responsibilities for developing and implementing administrative policies are not clearly defined. Duplication, conflicts, and blurred lines of authority exist among the various executive departments and agencies.

- There is an absence of direction and coordination in key areas, particularly financial management. Currently, there is no centralized, unified control over development and coordination of financial management policies. This has prevented standardization of procedures for cash management, debt and receivables collection, inventory, and other asset management, as well as useful financial reporting to senior officials.

- Fragmentation of administrative policy-making has caused a lack of high-level attention to significant opportunities for reducing government costs.

- Until the formation of Reform 88, the Office of Management and Budget (OMB) did not focus on management improvement. OMB continues, however, to be preoccupied with the annual budgetary process.

In the area of management information systems:

- Independent information systems for payroll, accounting, and asset management in each department and agency is inefficient, costly, and counterproductive.

- It is extremely difficult to extract from existing systems timely financial data including collection of debts owed the government, location and utilization of real property, inventories, and even identification of data processing systems currently in use.

- There is no central control over ADP systems, leading to expedient and temporary modifications rather than incorporation of technological advances in hardware and software.

- Agencies do not share information on techniques that could be utilized in other agencies.

In the area of budgeting, planning, and evaluation:

- Management of resources is concentrated on current year budgets.

- Management of government assets -- capital planning and cash management -- is a low priority.

- Evaluation of program results and collection of program data for planning and management purposes is not carried out effectively.

In the area of continuity of management:

- Turnover of key executives every 18 to 24 months prevents meaningful management improvement.

- An effective government counterpart to private sector profit incentives for management performance does not exist.

In the PPSS Report on Financial Asset Management, PPSS found the Federal Government lags far behind the private sector in management information systems, internal audit and accounting controls, and computer techniques. The task force recommendations called for improved cash management, debt collection, lending practices, and credit management. With federal cash transactions at 1983 levels, PPSS found the task force recommendations could save almost $14 billion over three years.

The third report related to S. 2230 is Automated Data Processing (ADP)/Office Automation. With the entire Federal Government dependent on smooth functioning of computer hardware and software, the government commits large amounts of resources to acquiring and operating these systems. The task force focused on ADP management, ADP acquisition, general systems resources, teleprocessing, office automation, and personnel.

The PPSS task force concluded that more effective management of information technology resources and substantial cost savings would result from centralization of overall management and policy, upgrading of obsolete automation, improved management of office automation, improved management of teleprocessing costs, and designation of a senior official in each agency to oversee ADP policy. PPSS estimated that implementation of all of its ADP/office automation recommendations would save $11.1 billion over three years.

S. 2230 contains more than 30 recommendations of the Grace Commission. Many provisions of the bill, including those relating to the Office of Financial Systems, agency controllers, accounting and internal control systems, agency financial statements, cash and credit management, and federal information policy, are consonant with Grace Commission recommendations.

Title I has already been discussed in depth by Mr. Connor. I would like to offer a few comments on how the remaining titles of S. 2230 and Grace Commission recommendations coincide and differ.

Title II. Accounting and Internal Control Systems

Both S. 2230 and PPSS would require agency compliance with General Accounting Office (GAO) accounting principles. The head of the financial management office within OFM would review agency reports to determine compliance. PPSS would require establishment of a specific timetable for compliance with GAO standards and S. 2230 would require compliance within two years. S. 2230 would make permanent the inclusion of a management report in the annual federal budget submitted by the President to Congress, a provision supported by CAGW.

Title III. Agency Financial Statements

S. 2230 and PPSS both would require agencies to produce annual financial statements, which would be subject to auditing. The financial statements would be required to comply with GAO standards.

S. 2230 would require bi-annual auditing; PPSS called for an annual audit.

PPSS recommended establishment of a full-time audit division within OFM, while S. 2230 would leave audit supervision in the hands of the Administrator of OFS. S. 2230 would allow two years to complete a plan for initial financial audits. PPSS called for hiring of additional audit staff and more attention to agency auditing by Inspectors General.

S. 2230 would require government corporations, boards, and commissions to be audited on an annual basis. This proposal is not part of the PPSS reports, but is supported by CAGW.

Title IV. Cash Management

Both S. 2230 and PPSS's Report on Financial Asset Management would establish cash management criteria for timely disbursement of federal funds, with a system of rewards and penalties as incentives for improved cash management.

Both would also reduce the amount of time within which states would be required to remit Social Security withholding (from 15 days to 3 days), and promote greater use of electronic funds transfer to pay both federal employees and federal program beneficiaries. Both S. 2230 and PPSS would establish a national lockbox system to receive payments to the government under the supervision of the Secretary of the Treasury. While PPSS recommends acceleration of current efforts in this area, S. 2230 would provide for a study and recommendations by the Secretary of the Treasury.

S. 2230 would additionally codify the recommendations of the Joint State/Federal Cash Management Reform Task Force of 1983. An Intergovernmental Interest Fund would be placed within the Treasury. Funds would be collected from states which earned interest on federal funds prior to distribution, and from the federal government when a state has to spend its own money on federal programs before it receives the federal funds.

Title V. Credit Management

There are considerable similarities between PPSS and S. 2230 in the area of credit extension and administration, as well as in debt collection. Both S. 2230 and PPSS would require that:

- interest rates for government loans be comparable to market rates;
- loan origination and application fees cover administrative costs;
- all loans include default, delinquency, and acceleration clauses; and,
- private sector models be used to improve agency credit practices.

PPSS recommended increased private sector participation in direct loans; S. 2230 would call for a one-year study on this subject.

S. 2230 would provide for subsidy statements in all loan programs; PPSS recommended OMB review of all subsidies to determine justification for loan rates.

S. 2230 would also prohibit granting of new loans to any applicant who defaults on a federal loan or loan guarantee, unless necessary to protect the government's interest. CAGW supports this provision.

In the area of debt collection, there are also many similarities between S. 2230 and PPSS. Both would:

- establish debt collection targets, and a system of incentives and penalties to meet targets;
- establish agency delinquency, default, and debt standards;
- use private sector collection agencies;
- use tax return information by agencies to help collect debt; and,
- require submission of reports on debt collection practices.

PPSS would make OMB responsible for uniform debt practices and procedures. S. 2230 would vest such authority in the Office of Financial Services and the Department of the Treasury, and give agencies one year to develop standards.

PPSS called for quarterly reports and audits; S. 2230 would require a bi-annual audit.

S. 2230 would require increased effort for debt collection, but is not as specific as PPSS in describing how this goal is to be reached.

Title VI. Federal Information Policy

Both S. 2230 and the PPSS Report on Automated Data Processing (ADP)/Office Automation would provide for centralization of federal information policy within OFM. S. 2230 places the existing OIRA in OFM; PPSS calls for a new Office of Federal Information and Resources Management. Although the titles are different, their functions would be similar. Within OFM policies for paperwork reductions, upgrading telecommunications and ADP processing systems, and financial controls would all be centralized in one office. Under both S. 2230 and PPSS, senior agency officials would be designated to implement information policy.

PPSS leaves GSA, reporting to OFM, in charge of acquisition, technical support, operations, and contracts. Under S. 2230, all technology and telecommunications revolving funds are consolidated within OIRA. It is not clear what GSA's role would be in this new system. The Administrator of OIRA would determine capital requirements for information systems, enter into multi-year contracts, and report to the OFM Director on the use of these funds. PPSS would delegate some authority for procurement to each agency, but only upon demonstration of competence and compliance with GSA procurement guidelines.

Where PPSS recommendations and S. 2230 diverge, CAGW believes adoption of the PPSS proposals would improve the bill.

Mr. Chairman, I commend you for your initiative and dedication to improving the management of our Federal Government. This is a substantial undertaking, but one which has far-reaching consequences. We cannot afford business as usual. That approach has led us down the path of huge deficits and a ballooning public debt. You have stated your bill would save $4 billion over five years. Prevention of future waste and inefficiency through restructured and accountable management and financial systems will save billions more once the new systems are functioning effectively.

I urge the Committee consider my comments and move S. 2230 to the full Senate as soon as possible.

THE CENTER FOR EXCELLENCE IN GOVERNMENT

20 F Street, N.W. 5th Floor Washington, D.C. 20001 (202) 628-2277

PREPARED STATEMENT

BEFORE THE U. S. SENATE COMMITTEE ON GOVERNMENTAL AFFAIRS

MAY 13, 1986

CHRISTOPHER T. CROSS
PRESIDENT
UNIVERSITY RESEARCH CORPORATION
CHEVY CHASE, MARYLAND

AND

EDWARD G. SANDERS
PRESIDENT
INTERNATIONAL PLANNING AND ANALYSIS CENTER
SEARS WORLD TRADE
WASHINGTON, D. C.

ACCOMPANIED BY MARK A. ABRAMSON, DIRECTOR OF THE CENTER

Mr. Chairman and Members of the Committee:

We are pleased to testify before you today. We are Principals of The Center for Excellence in Government, a non-profit organization comprised of individuals who are former senior government managers and are now managing in the private sector, and who are committed to improving management in government. The Center appreciates this opportunity to comment on S. 2230, the Federal Management Reorganization and Cost Control Act of 1986.

The Center's testimony today will be limited to Title I, "Improving Federal Management," of the bill. While The Center is not taking a position on the creation of an Office of Federal Management, our testimony attempts to raise a series of issues for the Committee to consider in its deliberations on the bill.

As an organization dedicated to improving the quality of management in the public sector, The Center is supportive of all efforts to deal creatively and positively with these matters. The Center welcomes hearings on this important topic. Under Senator Roth's leadership, this Committee has focused the attention of Congress, the Executive Branch, and the public on the need for effective management in government. The Center applauds these efforts.

A Broader Concept of Public Management is Needed Today

In our testimony today, we wish to convey our belief that what is needed, more than anything, is a different, broader concept of public management than is now in place. Today, the concept of public management put forward by legislative bodies and executive oversight agencies is largely a process one. But management, whether it be in the public or private sector, is more than a set of systems to administer financial, procurement, and personnel policies. It is certainly more than mandating additional reports and cutting costs. We need to understand that management requires more than just automated accounting systems and reviews of organizational structures.

Management means producing results. Effective public managers develop strategies which permit personnel to be productive within the constraints of the public-policy objectives of the programs they administer. They encourage people to take risks and do not attack them when they make a mistake. They inspire people to be excellent. They create procedures and a broad range of incentives that encourage excellence.

Management produces results by establishing a performance ethic among its people. This requires careful attention to and care for people in the organization -- how they are organized, controlled, motivated, promoted, rewarded, educated, and trained. Effective management is an an ethic that is created from the top down. Established organizations may be customer driven (IBM), quality driven (Mercedes-Benz), product driven (General Motors) or guided by a combination of these factors. From our experience, however, we have found only a few federal agencies that have created and sustained an over-arching performance ethic and the drive behind it.

Historically, Management Reforms Have Missed the Mark

We believe that systems and structures do not create high performance. To be sure, good systems and structures are important tools which can facilitate the task of management, but they alone do not get the job done.

Performance requires motivated people -- particularly motivated managers. Unfortunately, most of the attention given to public management today concentrates on creating still more control systems and new organizational structures. Adequate attention is not given to the cumulative impact of all "overhead activities" on the managers and people in government.

Management improvement and reforms rarely begin by asking these two basic questions:

- Are all the past improvements -- systems, structures, regulations -- helping or hindering managers? Do they motivate or demotivate?
- What do the appointed and career managers say they need to better perform their jobs? To achieve better results?

It's odd that most public management reforms are seen as something done to public managers, rather than for them.

Past management improvements have also tended to ignore many of the factors that must be brought together to enable managers to be effective -- people, administrative systems, vision, organization, pay systems, and professional characteristics. Improvements are made piecemeal and often uniformly applied across a diverse set of agencies.

To attempt to work on one segment of this complex set of factors without accounting for the others is, we believe, a serious mistake and compounds the mistakes made over time by most central staff offices.

We share the Committee's belief that more attention needs to be given to management in government. The Office of Federal Management, if appropriately focused, could provide that necessary attention. The remainder of our testimony will discuss roles that a central office of management should and should not play.

A government-wide management office can be either a positive or negative force. Regardless of what this Committee decides on the Office of Federal Management, the need for a broader concept of management oversight in government remains. The final part of our testimony will discuss two prerequistes for effective leadership in the area of management by either the new Office of Federal Management or the existing structures within OMB and OPM.

How A Central Management Office Might Improve Management

We believe that a dramatic improvement in the management of the federal government will require an approach that is significantly different from those tried in the past. Its primary emphasis must go beyond specific management systems, organizational structures, and cost-cutting.

A central management office could help implement a more performance-oriented management ethic in government. It could do so by playing at least five new roles not currently being assumed by other central offices:

(1) Seek Out and Remove Administrative Barriers to Performance. A new approach to management would view the achievement of "results" as the main objective of government and view "process" as only a means to that end. Increased attention needs to be given to the cumulative impact of all government-wide control systems and structures. There is an important role to be played in examining the many systems now in place in order to minimize the negative overall impact of those systems on performance. Such an examination would address two critical issues: (1) That the many review layers, procedures and regulations added over the years have reduced managers' ability to get results; and (2) That the role of the program manager has been diminished, and authority has become divorced from accountability. In effect, results-oriented management is no longer allowed.

A central office that could advocate deregulation of the administrative barriers that have grown up around managers would help to re-establish the relationship between management and accountability for results.

(2) Permit Flexible Management Solutions. A new approach to management will have to recognize diversity in federal agencies, rather than attempt to make them all conform to identical constraints. What makes sense for the Department of Defense may not be appropriate for the Department of Health and Human Services. Unfortunately, the current thinking presumes that every new idea developed to achieve a specific objective or to solve a perplexing problem in one agency is automatically applicable to all agencies. It is, therefore, not surprising that government has created a maze of overlapping rules and competing regulations in its search for uniform solutions that limit risks, but at the cost of accountability and impressive performance. A central agency that can evaluate the potential costs and payoffs from proposed management reforms would be helpful. One that could bring line managers together to build sound management reforms would be better.

(3) Allow and Encourage Bold Experimentation. A new approach to management would encourage, not stifle, innovation. Indeed, a central management agency could be at the forefront of nurturing new management ideas and helping agencies and bureaus try them out. In this role, it should encourage federal agencies to experiment with their own creative approaches to achieving their agencies' objectives, with the emphasis being on results rather than on uniform ways of doing things. It should help agency managers deal with inhibiting regulations, unfair criticisms, and meddling from Congress or central agencies.

(4) Amplify The Manager's Authority and Responsibilities. A new approach to management would ensure that managers who are charged with the responsibility for making federal programs work would also have the authority to produce the desired results. A central management office could focus attention on the need to give individual managers adequate authority. It could encourage cabinet secretaries, Presidents, and even Congressional committees to delegate more authority and flexibility to their line managers. It could create an environment in which agencies and their managers can flourish by focusing on results. In designing new systems and re-examining existing ones, its job will be to create systems in which good managers can perform well. These systems must be geared to improving existing performance and not just preventing bad performance.

(5) Advocate Improved Performance. A new approach would also emphasize greater leadership attention to producing results through government programs. A vitalized central management agency would have to more effectively involve the President (as Chief Executive Officer) in demanding high performance and praising it when it is achieved. Perhaps even more important, under a broader, new approach, the central management agency would have to work more closely with Congress to try to bring about greater awareness of the deleterious effects of excessive Congressional intervention in the day-to-day management of many federal programs.

In sum, the challenge before you and those of us vitally concerned with improving management in government is clear -- to build an environment in which dedicated, competent, and intelligent public managers can work effectively and produce results for society.

Avoiding The Dangers of a Central Management Agency

There are obvious dangers in creating a new Office of Federal Management -- it could make matters worse. Whether the dangers can be avoided depends on how the functions of the Office are defined, what its goals are, and how it operates. There are at least four pitfalls which must be avoided in designing a new central management office:

- If the central management agency merely continues the trend toward more "micro-management" of programs-- increased constraints, greater regulations, less management discretion, and more reports -- it will be a step backward.

- If the central management agency provides another layer of rules, reporting relationships and administrative guidance, it will be a burden rather than a help to all federal managers.
- If the central management agency is just one more oversight agency that is second-guessing the decisions of line managers and demotivating them whenever they try to be creative, it will be a burden rather than a help.
- If the central management agency merely institutionalizes the old habits and attitudes toward the career managers -- treating them as if they cannot be trusted and do not know how to perform -- it will be a burden rather than a help.

Preconditions for Establishing an Effective Office of Federal Management

We believe that there are two preconditions that should be met in order to have an effective Office of Federal Management:

First, the central management office must have the capability to influence other central agencies whose policies and practices are crucial to effective management:

the Office of Personnel Management, the Office of Management and Budget, and the General Services Administration. It is especially important that any attempt to upgrade the quality of federal management deal with federal personnel policy. For the most part, the Office of Personnel Management (OPM) is responsible for the structure of the work force, the performance appraisal systems, the entry system, and the education and training system that governs the civil Federal workforce. Without a close and effective working relationship between OPM and the central management agency, management in government cannot be improved.

Second, a central management office must be able to link management with the budget function and to make performance part of the budget equation. In our view, the current Office of Management and Budget has never successfully linked management with the budget function. Whether an Office of Federal Management is created or not, the need for this linkage will remain. In Washington today, more than at any time in our history, the force that drives the government consists of battles over the budget and subsequent authorization and appropriations processes for each department, agency, and program. Management needs to be part of that process, not divorced from it. Indeed, budgetary decisions today are all too often made in ways which discourage good management. Ways must be found instead to effectively use the budget process as leverage for improved management. In addition, there are other important processes, such as OMB's legislative clearance and regulatory review function, which should give greater weight to evaluating the potential beneficial or adverse impact of various initiatives on management performance.

Is A New Central Management Agency Needed?

We believe that public management today is too focused on process when more focus needs to be placed on results. Shifting this focus will require a coordinated effort to change attitudes, policies and practices.

A well-designed Central Office of Management could play an important and useful role here. An argument could also be made that the necessary roles could and should be established in OPM and on the "M" side of OMB. The Center believes the spelling out of the mission and the roles is an important step, regardless of whether the Office of Federal Management is established.

Conclusion

We enthusiastically support the efforts of the Chairman and Members of the Governmental Affairs Committee to examine ways in which the central management agency can provide better leadership in the area of management. Members of The Center for Excellence stand ready and willing to apply both their public and private sector management experience in addressing this important question.

In closing, we would like to emphasize the important role that this Committee could play in further developing and implementing a broader concept of public management. We feel that the Senate Governmental Affairs Committee is ideally suited to begin examining and bringing to public attention the conditions that now limit effective management in the federal government:

(1) the negative attitude of elected officials toward career managers,

(2) the tendency of legislative and oversight bodies to micro-manage programs,

(3) the administrative barriers to management that have been created by the incredible number of systems, structures and regulations put into place to "improve" management.

The active involvement of Congress as well as Executive Branch leaders is needed to create an environment in which federal managers and federal programs can perform at high levels.

STATEMENT OF

RAY KLINE
PRESIDENT
NATIONAL ACADEMY OF PUBLIC ADMINISTRATION

BEFORE THE
SENATE GOVERNMENTAL AFFAIRS COMMITTEE

ON

S.2230

A BILL TO IMPROVE THE MANAGEMENT OF THE FEDERAL GOVERNMENT
BY ESTABLISHING
AN OFFICE OF FEDERAL MANAGEMENT
AND FOR OTHER PURPOSES

May 13, 1986

Mr. Chairman, Members of the Committee:

It is a privilege and a pleasure to appear before this committee today to present the views of a panel of the National Academy of Public Administration on S.2230, "a bill to improve the management of the Government by establishing an Office of Federal Management in the Executive Office of the President, and for other purposes." With me is Alan Dean, Chair of the Academy's Standing Panel on Executive Organization and Management.

The National Academy is a nonpartisan organization formed in 1967 to advance the effectiveness of public management through advice and counsel to all levels of government. The Academy's members, elected by their peers, consist of distinguished practitioners and scholars of public administration throughout the country. In recognition of its public service role, the National Academy was given a Congressional charter in 1983, and we are pleased to offer our advice and counsel to the Congress and to the Committee.

While S.2230 contains many important proposals, I would like to concentrate my statement on Title I which would establish an Office of Federal Management.

Since World War II, the pivotal role in Federal management matters has resided with the Office of Management and Budget and its predecessor organization, the Bureau of the Budget. This management role is important. The operations of the Federal government dwarf the largest of our private sector corporations. Its management is one of staggering dimensions -- however measured. Federal programs impact every American citizen, state and local government and private corporation.

How well the government operates has become a matter of critical national concern. The Reagan Administration is on record countless times recounting the problems in Federal management and has undertaken an agenda of management initiatives -- such as Reform 88 -- to deal with them. The President's Private Sector Survey on Cost Control has dramatically underscored the situation with its 2,478 recommendations for management improvement, including one specifically addressed to shoring up the management arm of the President. The GAO regularly presents case after case of substandard federal management performance. Although many notable achievements have been made in recent years to improve Federal performance, the fact remains that much more needs to be done to set things aright.

As the Committee has learned, there are many views on what to do. Suggestions range all the way from the Grace Commission recommendation which would impose a private sector corporate-style headquarters to support the President as CEO of the Executive Branch to those who would attempt to fix things by shoring up the current structure.

For a number of years, the National Academy in numerous studies has pressed the view that the Federal government is failing to keep the management of its programs up to adequate standards of performance effectiveness, and is no longer providing fully effective service to the public. In 1983, a Panel of the Academy issued its report Revitalizing Federal Management: Managers and Their Overburdened Systems which described many of the management problems now facing the Federal manager and presented recommendations on what to do about them. Although recognizing a number of excellent Administration-led management improvement efforts, the Academy panel concluded that the present central management agency institutional base to sustain a continuing high level of government management is too weak and must be strengthened, and that the key to this strengthening lies in the current role of OMB. The panel strongly advocated the creation of an Office of Federal Management and had this to say about it:

> "... The Federal government's pressing needs for broad-based and sustained management reform can best be accomplished by the creation of a new Office of Federal Management in the Executive Office of the President which should become the framework for providing a more powerful and responsive leadership for management reform and improvement for the entire Federal government."

Why did the National Academy's panel feel so strongly that the OMB — which the Academy helped to create — was no longer the answer? What were the primary considerations that led to its proposal for an independent Office of Federal Management? Let me briefly summarize some of them.

The importance of the Federal budget is such that it all but totally preoccupies the attention of OMBs leadership, and this preoccupation is becoming greater. Despite occasional bursts of initiative, including the Reagan Administration's major and very laudable Reform '88 program and other management ventures, it is clear that management reform is never going to get the sustained attention and leadership it requires while it remains subservient to the all-consuming budget.

Even in the best of times, the total resources dedicated to management leadership in OMB have been inadequate to meet the demands of government, and today OMB finds itself falling even farther behind. As the Academy report puts it, "the systems of government are becoming obsolete or falling into disrepair faster than we are currently able to fix them." The management resources in OMB today are so underpowered and understaffed that they can never get on top of what needs to be done. This condition argues for a stronger, more energetic and more focused managerial organization of the type that S.2230 proposes.

It may be argued that the budget-examining elements of OMB also concern themselves with management matters in the programs and agencies which they examine, and therefore management is inseparable from budget examination. Even though budget examination often involves management issues, it is the panel's judgment that the existence of a new and more effective Office of Federal Management would provide substantially greater support to the budget review process as far as management improvement initiatives are concerned. In the past, when budget examiners have turned to the management side of OMB for assistance, or have encountered management problems which were government-wide in character, they have often been disappointed by the inability of the management forces to respond and to help in a timely way. The panel believes the

OFM will provide a capability which will make the budget process more effective and valuable in the implementation of Presidential management initiatives.

True management improvement demands sustained attention and continuity of effort. During several periods of its existence, the management elements of OMB, or parts of them, have performed well. But all too often it has been management improvement in fits and starts. What was the legacy of the Carter "President's Reorganization Project"? Will the next Administration continue the initiatives of Reform '88? Management improvement must be effectively planned, directed, and implemented in consideration of the longer term and not in four or eight-year spurts. It is not enough to mount occasional narrow projects for improvement and ignore the wider range of government activity. An Office of Federal Management, with a strong, comprehensive Congressional charter behind it and dedicated, committed leadership will certainly provide program breadth and continuity of effort far superior to that which has existed up to now.

Thus the National Academy panel strongly favors the creation of the Office of Federal Management as defined in Title I of S.2230. But there is one specific change in the provisions of Title I which I would like to address.

The Academy Standing Panel on Executive Organization and Management is impressed with the comprehensive listing of management responsibilities that would flow to the new OFM. It notes that the legislation would statutorily provide for three elements of the organization — the Office of Federal Procurement Policy and the Office of Information and Regulatory Affairs, already mandated by statute — and an Office of Financial Systems which would be created.

The Panel has no quarrel that the new OFM contain the functions of these organizations. But the bill would place into OFM many additional functions of great importance — functions which do not fit into these three organizational elements, but require strong organizational emphasis. For example, there is the area of intergovernmental relations, including policy aspects of almost $100 billion per year of grants assistance to state and local governments. There are the functions of government organization and structure; workforce planning and management and its implications for human resource management; and the large array of administration functions associated with managing the assets of government.

Such a broad functional span suggests the need for flexibility in management structure, so that resources can be applied as needed. One of the best examples of the need for flexibility is the emergence, in a very short span of time, of a broadened focus on regulatory management. I believe that both the Congress and the Executive Branch recognize that regulatory management has been a neglected arena of management concern. There are now more important regulatory programs in the Federal government than in any other period in the history of our government, and it is critically important that, in addition to the substance of each of these regulatory responsibilities, we develop a far stronger capacity to organize and manage these regulatory activities. That is why we strongly agree with the intent of S.2230 to make regulatory management part of the Office of Federal Management.

The Panel strongly recommends that the legislation be so drafted that OFM authorities and responsibilities are vested in the OFM Director, without locking specific subelements of the organization into statute. This would assure accountability of the office to the President and the Congress, and at the same time provide flexibility for OFM leadership to do what the office is charged to do.

OFM would have a relatively small staff in relation to its responsibilities, and the Director will need maximum flexibility in the use of that staff to meet current priority needs and demands at any given time — to put the talent where the problems are. We think that it would be far better and more effective if the structure and placement of key leadership positions were left to the authority of the OFM Director and not locked into certain boxes on the chart.

Unless this change is made, the panel fears that a single coherent organization would not be created, but rather an ineffective grouping of four largely independent entities, in which the OFM Director would have not real authority over his supposed leadership team, and with all of the conflict and inefficiency that such an arrangement invariably produces. I would note that, when it has created major cabinet departments and agencies, the Congress has most often followed the organizational principle laid down by the First Hoover Commission and placed full authority for the agency in the agency head, and has refrained from delegating independent powers to subordinate elements within the agency.

The panel favors a straightforward approach: create the office, define its responsibilities - as S.2230 does - in law, and mandate their accomplishment. We believe this arrangement would provide for an OFM more responsive, not only to the President, but to the Congress, as well.

In the final analysis, the success of a properly-constituted OFM will depend on the quality of its professional staff. There will have to be an appropriate blend of political and career executives occupying the most senior positions to assure responsiveness to Administration initiatives while at the same time providing continuity of effort for ongoing programs and an institutional memory for what has gone before. The professional staff will have to be larger, more senior, more generalist and more broadly experienced than has been the case in recent years in OMB. By background and by predilection, the staff will have to fit hand-in-glove with the role of the OFM — a policy and planning organization which attends to problems at the broad management level and eschews intervention into the detailed operations of agency management. In its Revitalization report, cited earlier, the Academy panel made a solid case for flexible, decentralized management systems — systems that let managers manage within the agencies. The great pitfall to be avoided at all costs is the OFM becoming another bureaucratic layer of centralized control with its strangulating effect on agency line management.

One of the questions most often asked of the Academy panel is, "Aren't you really advocating four central agencies (OFM, Budget, GSA, OPM) instead of three? Won't this simply worsen the bureaucratic problems of central agency relationships?" The panel in its Revitalization report responds as follows:

> "This (OFM) recommendation is not intended to reduce the capacity of the Office of Personnel Management or the General Services Administration to render services to the departments and agencies of the Executive Branch. However, the question must be answered as to the management policy roles of each of these agencies. OMB has always considered that its role and authority is Presidential and thus includes all activities of the government. This means that OMB has, in the past, involved itself in OPM and GSA responsibilities — regularly through the budget, and selectively with respect to management issues — on behalf of the President. The Academy Panel believes that the proposed Office of Federal

Management should assume the management leadership responsibilities of OMB and should continue to serve as the single agency which can advise the President on all Federal management matters. There is no reason to believe that the new OFM would impair these other central agencies, and each would continue to be fully responsible for its own policy areas as defined by the President and relevant statutes. Said another way, the President would look to the Office of Federal Management for management policy and objectives for the whole government and — within that framework — to OPM and GSA for policy and implementation in their respective areas."

This concludes my statement, Mr. Chairman. We would be happy to respond to any questions.

STATEMENT BY
J. EDWARD SHERIDAN
REPRESENTING THE PRIVATE SECTOR COUNCIL'S
CHIEF FINANCIAL OFFICERS TASK FORCE
ON S.2230 BEFORE THE SENATE COMMITTEE
ON GOVERNMENT AFFAIRS
MAY 13, 1986

MY NAME IS J. EDWARD (TED) SHERIDAN. CURRENTLY, I AM A PROFESSOR AT THE COLUMBIA BUSINESS SCHOOL, HAVING SERVED 10 YEARS AS CHIEF FINANCIAL OFFICER AT AMF INCORPORATED AND 2 YEARS AT FAIRCHILD INDUSTRIES. TODAY, I AM REPRESENTING THE PRIVATE SECTOR COUNCIL WHERE I SERVE ON THE CHIEF FINANCIAL OFFICERS TASK FORCE AS A REPRESENTATIVE OF THE FINANCIAL EXECUTIVE INSTITUTE.

THE PRIVATE SECTOR COUNCIL IS A NONPROFIT, NONPARTISAN ORGANIZATION DEDICATED TO IMPROVING MANAGEMENT EFFICIENCY IN GOVERNMENT BY PROVIDING PRO BONO ADVISORY AND CONSULTING SERVICES. IT USES SPECIFIC PRIVATE SECTOR EXPERIENCE, KNOWLEDGE AND EXPERTISE TO ESTABLISH COOPERATIVE PROGRAMS WITH GOVERNMENT AGENCIES TO IMPROVE MANAGEMENT AND, THEREBY, HELP TO REDUCE THE NATIONAL DEFICIT. SINCE ITS INCEPTION IN MARCH 1983, THE PRIVATE SECTOR COUNCIL HAS ENTERED INTO WORKING AGREEMENTS WITH 9 MAJOR FEDERAL DEPARTMENTS AND AGENCIES, HAS COMPLETED 42 PROJECTS TO DATE, IS WORKING ON 27 ADDITIONAL PROJECTS, AND HAS BEEN CREDITED FOR ASSISTING FEDERAL OFFICIALS ON PROJECTS THAT RESULTED IN

AT LEAST $1 BILLION IN INTEREST SAVINGS AND $8 BILLION IN WORKING CAPITAL REDUCTION. THE PRIVATE SECTOR COUNCIL IS SUPPORTED BY SOME 100 MAJOR CORPORATIONS, FOUNDATIONS AND ASSOCIATIONS THAT ASSIGN PRO BONO EXPERTS TO WORK ON PROJECTS AND PROVIDE FINANCIAL ASSISTANCE FOR THE OPERATING EXPENSES.

IN MY TESTIMONY TODAY, I WOULD LIKE TO (1) DESCRIBE BRIEFLY HOW CHIEF FINANCIAL OFFICERS DEVELOPED IN CORPORATIONS, (2) OFFER OUR COMMENTS ON THE ORGANIZATIONAL PROPOSAL OF S.2230 AND (3) PROVIDE A FEW COMMENTS ON THE FUNCTIONAL PROPOSAL OF S.2230.

CHIEF FINANCIAL OFFICER IN THE PRIVATE SECTOR. THE EMERGENCE OF THE ROLE OF CHIEF FINANCIAL OFFICERS' (CFO) IN THE PRIVATE SECTOR HAS BEEN AN EVOLUTIONARY ONE IN RESPONSE TO THE GROWING SIZE AND COMPLEXITY OF CORPORATE ORGANIZATIONS AND THE INCREASING SPECIALIZATION AND IMPORTANCE OF THE FINANCIAL FUNCTION.

FOR THE MOST PART OF EMERGENCE OF THE CFO IS A POST WORLD WAR II PHENOMENON THAT BECAME UNIVERSAL IN LARGER CORPORATIONS IN THE FIFTIES AND SIXTIES AND HAS NOW MOVED TO THE RANKS OF THE MORE MODEST SIZED FIRMS.

ITS CREATION IS THE RESULT OF TWO FACTORS:

(A) THE DELEGATION OF RESPONSIBILITIES OF THE CHIEF EXECUTIVE OFFICER (CEO).

(B) THE EXPLOSION OF FINANCIAL RESPONSIBILITIES HAVING A MATERIAL IMPACT ON COST CONTROL, PROFITABILITY AND THE OPTIMUM UTILIZATION OF ASSETS.

AS BUSINESS HAS EVOLVED INTO MORE COMPLEX ENTERPRISES WITH PROFESSIONAL MANAGEMENT, THE ROLE OF THE CHIEF EXECUTIVE HAS CHANGED RADICALLY. THE CEO CAN NO LONGER BE THE INVENTIVE GENIUS, PRODUCTION MANAGER, CHIEF SALESMAN AND THE PRINCIPAL SOURCE OF CAPITAL. THESE FUNCTIONS HAVE NOW BECOME DELEGATED WITHIN THE LINE AND STAFF ORGANIZATIONS BECAUSE ONE INDIVIDUAL CAN NOT CONTROL ALL THESE RESPONSIBILITIES. PARALLELING THIS HAS BEEN THE CHANGE IN CHARACTER OF THE ROLE OF FINANCE IN MODERN BUSINESS.

AT ONE TIME THE CHIEF CONCERN OF FINANCE WAS THE KEEPING OF BOOKS IN A MONOLITHIC, REGIONAL ENTERPRISE WITH RELATIVELY SIMPLE FINANCING REQUIREMENTS. THIS ENTAILED DEALING WITH THE LOCAL BANKER FOR SHORT TERM NEEDS AND OCCASIONALLY TRAVELLING TO WALL STREET FOR THE ISSUANCE OF LONG TERM BONDS OR STOCK. RATES RARELY MOVED AND THEN ONLY SLOWLY. THE BUSINESS CYCLE WAS LONG AND RELATIVELY PREDICTABLE. THE BEST AND MOST IMAGINATIVE EFFORTS OF THE FINANCIAL FUNCTION HAD BUT A MODEST IMPACT ON THE RESULTS OF THE ENTERPRISE. AS LONG AS THE ASSETS WERE PROPERLY COUNTED AND THERE WERE NO MAJOR FINANCING MISCALCULATIONS, THE FINANCIAL RESPONSIBILITIES WERE PROPERLY SERVED.

THE MODERN CORPORATION DEALS IN MANY TECHNOLOGIES AND PROCESSES SERVING A VARIETY OF MULTINATIONAL MARKETS. PRODUCT AND ECONOMIC CYCLES ARE SHARP AND ERRATIC AND FINANCIAL MARKETS ARE UNPREDICTABLE. WITHIN THE ORGANIZATION THE SCOPE AND COMPLEXITY OF DIVERSE OPERATIONS AND THE REQUIREMENT FOR INSTANTANEOUS INFORMATION HAVE DRAMATICALLY CHANGED THE NATURE AND FUNCTION OF FINANCIAL REPORTING AND CONTROL SYSTEMS.

FOSTERED BY THESE CHANGES, THE CFO HAS EVOLVED INTO A ROLE THAT ENCOMPASSES LINE, STAFF AND POLICY FUNCTIONS. THIS INDIVIDUAL MUST SERVE AS ADVISOR TO THE BOARD OF DIRECTORS AND CHIEF EXECUTIVE, AND IS A MEMBER OF THE MOST SENIOR POLICY SETTING GROUP IN THE CORPORATION. HE PRESIDES OVER STAFF REVIEW FUNCTIONS, AND, AT TIMES, PERSONALLY NEGOTIATE CONTRACTS OF MAJOR IMPORTANCE. THE CHIEF FINANCIAL OFFICER IS EXPECTED TO BE KNOWLEDGEABLE OF AND RESPONSIBLE FOR ALL ASPECTS OF THE FINANCIAL ORGANIZATION AND OPERATIONS OF THE CORPORATION. OFTEN, HE IS THE PRINCIPAL ARCHITECT OF THE FINANCIAL SYSTEMS AND CONTROLS. REPORTING TO THE CFO WILL BE THE TREASURER, AND CONTROLLER AS WELL AS BUDGET, TAX, INSURANCE AND, IN SOME CASES, INTERNAL AUDIT FUNCTIONS. AS A RESULT OF THIS INFLUENCE AND RESPONSIBILITY, THE FUNCTION HAS MOVED UP IN THE HIERARCHY. HE GENERALLY REPORTS TO THE CHIEF EXECUTIVE AND IS PRESENT AT ALL BOARD MEETINGS. THE NEED TO REPRESENT ALL OF THE DIVERSE FINANCIAL UNDERTAKINGS OF THE FIRM AND THE CENTRALIZATION OF CONTROL HAS LEAD TO THE IMPORTANCE OF THE

OFFICE. THIS BASE AND THE CFO'S EXPERTISE PROVIDES THE EFFECTIVENESS AND AUTHORITY THAT THE RESPONSIBILITIES DEMAND.

AT THIS STAGE IN THE DEVELOPMENT OF THE CORPORATE FORM, THE FOCUS UPWARD OF INFORMATION AND ADVICE TO THE POLICY LEVEL THROUGH THE CFO AND DOWNWARD IN PROMULGATION OF PROCEDURES AND ACTION ORDERS WORKS WELL IN THE FINANCIAL MANAGEMENT OF LARGE, COMPLEX PRIVATE SECTOR ENTERPRISES. IT PROVIDES THE MEANS TO BRING TOGETHER THE RESOURCES OF THE ORGANIZATION AND TO COORDINATE AND CONTROL THE FINANCIAL ACTIVITY OF OFTEN WIDELY DIFFERENT OPERATIONAL REQUIREMENTS. AS THE DEMAND ON THE OGRANIZATION CHANGE, SO WILL THE CORPORATE FORM AND UNDOUBTEDLY THE ROLE OF THE CHIEF FINANCIAL OFFICER.

IN PARALLEL, AS CONDITIONS, DEMANDS AND VIEWS EVOLVE IN THE PUBLIC SECTOR, WE HAVE OBSERVED THAT SERIOUS THINKING IS TAKING PLACE IN THE GOVERNMENT AS HOW BEST TO MANAGE FINANCIAL ACTIVITIES, AS IN THE CASE OF S.2230. THE CHARTER AND OBJECTIVES OF THE MANAGERS OF THE FEDERAL FINANCIAL SYSTEM ARE OBVIOUSLY QUITE DIFFERENT FROM THOSE OF THE PRIVATE SECTOR. YET, WE SHARE MANY OF THE SAME CONCERNS AND CONFRONT SITUATIONS SIMILAR IN MANY REGARDS.

PRIVATE SECTOR COUNCIL REVIEW OF S.2230. TO SHARE OUR EXPERIENCE WITH THE GOVERNMENT, THE AD HOC COMMITTEE OF THE PRIVATE SECTOR COUNCIL, COMPOSED OF SEVERAL CORPORATE CHIEF FINANCIAL OFFICERS AND THEIR ADVISORS, REVIEWED S.2230 AND SUPPORT THE INTENT TO IMPROVE FINANCIAL MANAGEMENT IN THE FEDERAL GOVERNMENT. WE WOULD LIKE TO OFFER OUR COMMENTS IN TWO AREAS OF THE BILL: THE ORGANIZATIONAL PROPOSAL AND SELECTIVE FUNCTIONAL IMPROVEMENTS.

ORGANIZATIONAL PROPOSAL OF S.2230

FIRST, ON THE ORGANIZATIONAL PROPOSAL:

ALTHOUGH WE BELIEVE THAT THE PRIVATE SECTOR EXPERIENCE CAN HAVE BROAD APPLICATIONS IN GOVERNMENT, IT WOULD BE PRESUMPTUOUS TO COMMENT SPECIFICALLY ON THE MODEL PROVIDED IN THE BILL AT THIS TIME. HOWEVER, WHILE WE SUPPORT THE CONCEPT OF A CHIEF FINANCIAL OFFICER, WE FEEL WE SHOULD NOT SPEAK TO THE ORGANIZATIONAL PLACEMENT WITHOUT FURTHER DELIBERATION, EXCEPT TO SAY THAT IT SHOULD BE VERY HIGH IN THE GOVERNMENT ORGANIZATION, PROBABLY HIGHER THAN THAT CONTEMPLATED IN THE BILL.

IN REVIEWING S.2230, WE HAVE ALSO LOOKED AT OTHER STUDIES AND REPORTS THAT RECOMMENDED REORGANIZATION OF FINANCIAL MANAGEMENT ACTIVITIES IN THE GOVERNMENT. WE NOTED THAT, ALTHOUGH THE ULTIMATE CONCLUSIONS AND SUGGESTIONS FOR RESTRUCTURING OF FINANCIAL MANAGEMENT ACTIVITIES VARIED WIDELY, THEY IDENTIFIED AT LEAST THREE COMMON CAUSES FOR THE PRESENT CONDITIONS -- THE PRESENT FINANCIAL SYSTEMS ARE FRAGMENTED AS TO AUTHORITY; LACK CONTINUITY OF LEADERSHIP; AND PROVIDE INADEQUATE TOOLS AND RESOURCES TO ACCOMPLISH THE OBJECTIVES. WE BELIEVE

THAT THESE THREE ROOT CAUSES, DISCUSSED IN THE FOLLOWING PARAGRAPHS, NEED TO BE ADDRESSED FULLY IN ANY DELIBERATION OF THE SUBJECT MATTER.

THE PROBLEM OF FRAGMENTATION. THE CENTRAL AUTHORITIES AND RESPONSIBILITIES FOR FINANCIAL MANAGEMENT POLICIES AND GUIDANCE ARE DISTRIBUTED AMONG SEVERAL AGENCIES: THE OFFICE OF MANAGEMENT AND BUDGET, THE DEPARTMENT OF THE TREASURY, THE GENERAL ACCOUNTING OFFICE AND, TO A LESSOR EXTENT, THE GENERAL SERVICES ADMINISTRATION AND THE OFFICE OF PERSONNEL MANAGEMENT. CONSEQUENTLY, DUE EITHER TO DISAGREEMENT OR ABSENCE OF COORDINATION, CONFLICTING INSTRUCTIONS HAVE BEEN ISSUED TO THE AGENCIES. THESE MIXED SIGNALS CONFUSE AGENCIES AND MAY DELAY SYSTEMS DEVELOPMENT EFFORTS. THEY MAY BE USED AS AN EXCUSE FOR DELAYING THE MUCH NEEDED IMPROVEMENT EFFORTS. ON OTHER OCCASIONS, AGENCIES MAY FOLLOW GUIDELINES MORE SUITABLE TO THEM THEREBY ADDING TO THE INCONSISTENCIES AMONG SYSTEMS. CLEARLY, THERE IS A NEED FOR A SINGLE VOICE FOR FINANCIAL MANAGEMENT POLICY. WE, THEREFORE, BELIEVE THAT PULLING TOGETHER THE RELATED AUTHORITIES AND POLICY RESPONSIBILITIES IS CRITICAL TO ELIMINATE FRAGMENTATION AND COST INEFFICIENCIES.

THE PROBLEM OF DISCONTINUITY. IN GENERAL, THE POSITIONS THAT INFLUENCE THE DIRECTION OF FINANCIAL MANAGEMENT ARE OCCUPIED BY POLITICAL APPOINTEES. THIS IS NOT BAD IN ITSELF, BUT WHAT IS OF CONCERN IS THAT THESE APPOINTEES STAY ON THE JOB, WE HAVE OBSERVED, FOR AN AVERAGE OF ABOUT 20 MONTHS. JUST ABOUT THE TIME THEY

BECOME FAMILIAR WITH THEIR ORGANIZATION AND HAVE ESTABLISHED AN AGENDA, THEY LEAVE. NEW ONES COME IN WITH A NEW OUTLOOK, OBJECTIVES, PRIORITIES AND AGENDAS, OFTENTIMES NEGATING OR SLOWING THE MOMENTUM OF THE PROGRAMS OF THEIR PREDECESSORS. FURTHER, THOSE WHO EXPECT TO STAY FOR A SHORT DURATION ARE PRIMARILY INTERESTED IN QUICK FIXES AND SHORT-TERM ACHIEVEMENTS THAT COULD BE DETRIMENTAL TO LONG-RANGE NEEDS AND OBJECTIVES AND AN ORDERLY APPROACH TO SYSTEMS IMPROVEMENTS. CONSEQUENTLY, LONG-RANGE PLANNING AND COMMITMENT ARE OFTEN ABSENT, AND, WHEN EXISTENT, ARE FREQUENTLY DISRUPTED. WE BELIEVE THAT THE TERM OF THE PERSON ACTING AS CHIEF FINANCIAL OFFICER SHOULD BE SUFFICIENTLY LONG TO SET PRIORITIES, ESTABLISH SHORT-TERM AND LONG-TERM OBJECTIVES, AND PROVIDE OPPORTUNITY FOR COMMITMENT TO THEIR ACHIEVEMENTS. WE ALSO BELIEVE THAT THAT TERM SHOULD SPAN MORE THAN ONE TERM OF A PRESIDENT -- POSSIBLY 6 OR 7 YEARS. HE/SHE SHOULD BE ALLOWED TO BE REAPPOINTED FOR ANY PERIOD OF TIME UP TO AN ADDITIONAL FULL TERM ASSUMING THAT THE PERFORMANCE IS "ACCEPTABLE". SUCH PERSON SHOULD BE SELECTED FREE OF THE POLITICAL PATRONAGE THAT OCCURS WHEN ADMINISTRATIONS CHANGE AND SHOULD BE SELECTED ON THE BASIS OF INTEGRITY AND DEMONSTRATED ABILITY WITHOUT REGARD TO POLITICAL AFFILIATION. THE PERSON MUST BE A CONSENSUS BUILDER AND ADEPT AT HUMAN RELATIONS, CAPABLE OF WORKING WITH BOTH ELECTED AND CAREER OFFICIALS.

THE PROBLEM OF THE LACK OF RESOURCES. IN THE 1950'S AND EARLY 1960'S, THE PRIVATE SECTOR LOOKED UP TO THE FEDERAL GOVERNMENT AS THE LEADER IN THE APPLICATION OF COMPUTERS AND RELATED TECHNOLOGIES. IN THE 1980'S, WE FIND THAT THIS RELATIONSHIP IS BEING COMPLETELY REVERSED. WHILE THE PRIVATE SECTOR HAS MADE NEEDED INVESTMENTS IN COMPUTER AND COMMUNICATION TECHNOLOGY FOR BETTER MANAGEMENT, INFORMATION SYSTEMS AND ACCOUNTING SYSTEMS, THE GOVERNMENT HAS LAGGED BEHIND SUBSTANTIALLY. IN MANY CASES, THE GOVERNMENT IS ONE, TWO OR EVEN THREE GENERATIONS BEHIND THE PRIVATE SECTOR IN SYSTEM APPLICATION. THE ENORMOUS OPERATION OF THE GOVERNMENT WITH UNIMAGINABLE COMPLEXITY WHICH CONSUMES 25 PERCENT OF THE GROSS NATIONAL PRODUCT NEEDS TO BE MANAGED WITH MORE MODERN TOOLS AND TECHNOLOGY. WE UNDERSTAND THAT WE ARE IN A PERIOD OF LEAN BUDGETS AND THE NEED FOR BEING FRUGAL. WE ALSO UNDERSTAND THAT DURING PERIODS OF LEAN BUDGET, THE RATCHET TENDS TO BE APPLIED FIRST TO OVERHEAD ACTIVITIES (BEFORE PROGRAM ACTIVITIES) WHICH INCLUDES LIMITING FINANCIAL MANAGEMENT PROGRAMS.

HOWEVER, UNLESS THERE IS STRONG SUPPORT FROM THE CONGRESS AS WELL AS THE EXECUTIVE BRANCH AND THE FIRM COMMITMENT OF RESOURCES FOR AN EXTENDED NUMBER OF YEARS, THE ABILITY TO ACHIEVE DESIRED REFORMS AND THE UPGRADING OF FINANCIAL SYSTEMS WILL NOT OCCUR. NO REORGANIZATION OR POLICY PRONOUNCEMENT ALONE WILL ACCOMPLISH THE WHOLESALE IMPROVEMENTS IN COST EFFECTIVE FINANCIAL MANAGEMENT SYSTEMS THAT ARE REQUIRED. WE SUPPORT THE IDEA OF

PROVIDING A LINE-ITEM BUDGET FOR NEW SYSTEMS DEVELOPMENT PURPOSES TO THE CHIEF FINANCIAL OFFICER FOR DISTRIBUTION TO THE AGENCIES CONSISTENT WITH OVERALL LONG-RANGE PLANS AND OBJECTIVES. IDEALLY, SUCH A BUDGET SHOULD BE FOR MULTIPLE YEARS.

FUNCTIONAL PROPOSAL OF S.2230. NOW, A FEW REMARKS CONCERNING SELECTIVE FUNCTIONAL AREAS.

WE BELIEVE THAT TITLE IV, CASH MANAGEMENT; TITLE V, CREDIT MANAGEMENT; AND TITLE VI, DEBT MANAGEMENT, ARE VERY, POSITIVE AND WOULD ESTABLISH NEEDED STATUTORY POLICIES TO ENABLE BETTER MANAGEMENT IN THESE AREAS. WE WOULD LIKE ALSO TO COMMEND PUBLICLY THE EFFORTS OF THE REPRESENTATIVES OF THE OFFICE OF MANAGEMENT AND BUDGET, TREASURY AND THE STATES FOR WORKING TOGETHER TO PROPOSE A SYSTEM FOR AN EQUITABLE PAYMENT ARRANGEMENT BETWEEN THE FEDERAL AND STATE GOVERNMENT WHICH IS REFLECTED IN S.2230. WITH RESPECT TO SPECIFIC PROVISIONS, WE OFFER THE FOLLOWING SUGGESTIONS:

1. TITLE V, SEC. 502, SUBCHAPTER I, (14)(A). DEFAULT SHOULD OCCUR, IN THE CASE OF A DIRECT LOAN, WHEN THE ACCOUNT IS PAST DUE OVER 120 DAYS, AND NOT 180 DAYS, AS IN THE PRIVATE SECTOR.
2. TITLE V, SEC 502, SUBCHAPTER II, SEC 3815. A DEFINITION FOR THE TERM "ACCELERATION" SHOULD

BE INCLUDED TO SAY "ENTIRE REMAINING PRINCIPLE BALANCE SHALL BE DUE AND PAYABLE IMMEDIATELY."

3. TITLE V, SEC 502, SUBCHAPTER II, SEC 3816. THIS SECTION SHOULD BE EXPANDED TO INCLUDE THE AUTHORITY TO SELL TO THE PRIVATE SECTOR -- IN BULK -- WITHOUT GUARANTEEING LOAN ASSETS OF THE GOVERNMENT.
4. TITLE V. SEC 502, SUBCHAPTER III, SEC 3821. WE SUPPORT THE IDEA OF ESTABLISHING AGENCY COLLECTION TARGETS. HOWEVER, AN INCENTIVE SYSTEM BASED SOLELY ON THE PERCENTAGE OF TARGETS ACHIEVED MAY ENCOURAGE UNREALISTIC TARGETS. WE BELIEVE THAT A BETTER WAY TO ENCOURAGE MORE COLLECTIONS WOULD BE TO ALLOW AN AGENCY TO RETAIN A CERTAIN PERCENTAGE OF COLLECTIONS ABOVE A PREDETERMINED AMOUNT BUT STILL BELOW THE COLLECTION TARGETS. FURTHER, THE AMOUNTS TO BE RETAINED BY THE AGENCIES SHOULD BE EARMARKED FOR FINANCIAL AND OPERATING SYSTEM ENHANCEMENTS AND DEVELOPMENTS.

FINALLY, WE WOULD LIKE TO LEAVE FOR THE RECORD A COPY OF OUR REPORT ON "A STRATEGY FOR IMPROVING FEDERAL CREDIT PROGRAM MANAGEMENT," PREPARED AT THE REQUEST OF THE STAFF OF THE SENATE BUDGET COMMITTEE A LITTLE OVER A YEAR AGO. PLEASE NOTE THAT MANY OF THE SUGGESTIONS PARALLEL THE PROVISIONS OF S.2230 CONCERNING CREDIT AND

DEBT MANAGEMENT. WE BELIEVE THAT THERE ARE OTHER ELEMENTS OF THIS REPORT YOU MIGHT WANT TO INCLUDE IN ENHANCING THIS BILL.

AS A MEMBER OF THE PRIVATE SECTOR COUNCIL'S CHIEF FINANCIAL OFFICERS TASK FORCE, I WOULD LIKE TO OFFER OUR SERVICES AS A RESOURCE AS YOU CONTINUE TO DELIBERATE ON S.2230. IF YOU DESIRE, WE WOULD BE PLEASED TO PROVIDE OUR ASSISTANCE AND PERSONAL COUNSEL WHEREVER POSSIBLE ESPECIALLY IN THE DELIBERATION OF THE ORGANIZATION STRUCTURE, FINANCIAL SYSTEMS OBJECTIVES AND IN CASH, CREDIT AND DEBT MANAGEMENT. WE HAVE FOUND THAT IN OUR NORMAL WORK, SHARING CORPORATE EXPERIENCES AND KNOWLEDGE DOES GO A LONG WAY TO IMPROVING FINANCIAL MANAGEMENT IN GOVERNMENT. WE ARE EAGER TO RENDER FURTHER ASSISTANCE.

THIS CONCLUDES OUR TESTIMONY. WE APPRECIATE THE OPPORTUNITY FOR THE PRIVATE SECTOR COUNCIL TO TESTIFY ON THIS VERY SIGNIFICANT TOPIC.

I WILL BE PLEASED TO ANSWER ANY QUESTIONS YOU MAY HAVE.

TESTIMONY BY

ROLAND W. BURRIS
COMPTROLLER
STATE OF ILLINOIS
and
PRESIDENT
NATIONAL ASSOCIATION OF
STATE AUDITORS, COMPTROLLERS AND TREASURERS

SPEAKING ON BEHALF OF
NATIONAL ASSOCIATION OF
STATE AUDITORS, COMPTROLLERS AND TREASURERS

BEFORE THE SENATE COMMITTEE ON
GOVERNMENTAL AFFAIRS

MAY 13, 1986

A CHIEF FINANCIAL OFFICER FOR THE UNITED STATES OF AMERICA

BY ROLAND W. BURRIS
STATE OF ILLINOIS

The creation of a Chief Financial Officer for the United States of America is an idea whose time has come.

I have been saying so for almost three years; I am delighted that Senator William Roth, Jr., agrees and has begun to take steps to make the position of a federal Chief Financial Officer a reality, or as his bill calls it, the Financial Systems Administrator.

My interest in the creation of such a position grows out of my experience as a state chief financial officer and president of the National Association of State Auditors, Comptrollers and Treasurers. As the Illinois State Comptroller, my office has been in the forefront of developing a model state accounting system guaranteeing budget consistency between state agencies, a reduction in the amount and cost of financial data collecting, better agency performance evaluation and improved state financial reporting to the taxpaying public. For these efforts, the Illinois Comptroller's Office was awarded the Certificate of Conformance -- an accounting honor rarely received by a state fiscal control agency. Illinois is not alone among our individual states in successfully rationalizing state financial budgeting and planning; most state accounting operations have, more or less, done the same thing.

Still, the federal government has much to learn about sound government fiscal management. In fact, federal fiscal operations often defy sound mangement and planning: its 427 accounting systems breed an obvious inefficiency at the very least. Unfortunately, the cost side of this fiscal mismanagement brings a plethora of government spending abuses. Everyone is mindful of military misspending: lavatory seats, coffee makers, hammers and screws purchased at king's ransom prices. But, poor cost control and management goes beyond government spending for military needs.

Chairman Roth has written: "...The problems of government fraud, waste and abuse have grown to epidemic proportions." And, as the United States Government

Accounting Office recently reported, "Billions Wasted in Faulty Federal Accounting." To which Comptroller General Charles Bowsher has observed: "Overcharges for goods and services, cost overruns, overpayments, the purchase of faulty equipment and a host of problems related directly to inadequate government internal control and accounting systems...erode the public's confidence in government."

And it should be noted that Mr. Bowsher and others have made serious efforts to undo this federal fiscal morass. A string of acronymic-labeled reforms have been advocated and sometimes tried; their effect, as we sit here discussing the need to provide sound federal government fiscal controls, has obviously been negligible. Most recently, the Financial Integrity Act of 1982 was passed to identify and rectify federal agency control and accounting weaknesses; four years later, as the Government Accounting Office reported, the evidence of fiscal problems continues to be collected, without, unfortunately, any remedies being effected.

But the need, today, in the age of Gramm-Rudman-Hollings is not to merely identify fiscal weaknesses, but to change them for the better. The American taxpayer should expect no less from a government that spends over $2 billion of their tax dollars each and every day of the year.

In my mind, an effective federal Chief Financial Officer would have the following features:

-- An independent executive agency with ranking equivalent to the United States Comptroller General. This is crucial. In the Roth bill, his proposed Financial Systems Administrator would not have the authority to bring about federal fiscal management reform. By placing him or her in a subordinate agency position, any Chief Financial Officer would be reduced to merely generating more paperwork detailing the on-going lack of sound accounting methods at the federal level. Also, a fifteen year, non-renewable term, not the four years suggested by the Committee Chairman, would allow the federal Chief Financial Officer to be above the quadrennial turmoil of American politics; it would also allow him or her to concentrate on the need at hand --development of sound fiscal controls for federal govermental operations. This task includes the Chief Financial Officer management and coordination of the financial activities of all branches of the federal government. The specific Chief Financial Officer functions would include:

- keeping of fund, receipt and appropriation account balances;
- being the primary disburser of federal payments;
- being in charge of depositing federal revenues;
- recommending to the President, the Congress and executive branch entities methods, practices and procedures relating to the collection, distribution, and evaluation of financial information;
- development of accounting standards and procedures for use by each governmental branch entity;
- ensuring that the President, the Secretary of the Treasury, and the Congress are kept fully informed about the financial condition of the federal government and state of financial management within the federal government, including the effect of improvements made and the status of changes in progress;
- developing financial software and hardware computer standards for the federal government;
- being the central financial record-keeping repository, including all federal personal and real property holdings;
- establish, in consultation with the Office of Personnel Management, government-wide personnel qualifications and job descriptions for all Executive agency financial management positions;
- maintaining in cooperation with the United States Attorney General overdue claims owed the federal government

and

- maintaining contact with the financial officers of state and local governments and foster the sharing of information concerning financial management standards, techniques and processes.

In general, it is important to note that these duties will not allow a future Chief Financial Officer to formally control the fiscal operations of the federal government. But, rather, his or her role is to devise procedures so federal accounting practices are uniform and in use throughout the federal governmental network and not participate in agency policy development.

I realize that while securing fiscal information from federal agencies, the question of national security interests about sensitive information may arise. Therefore, I propose that the Chief Financial Officer's access to official information does not impinge on the confidentiality of confidential appropriations either where the Congress deems that the certificate of a designated official is sufficient accounting for an expenditure or where appropriations are made to an imprest account for which disbursements are made by a designated official.

In order to facilitate the structuring and operation of this office, I suggest that a federal Chief Financial Officer also have the following senior staff assistants:

-- Deputy Chief Financial Officer;

-- Assistant Chief Financial Officer for Accounting, or the federal government's chief accountant with the responsibility for devising accounting rules, issuing accounting manuals, depositing receipts and issuing checks, maintaining accounting records, and issuing financial reports and statements based upon these records;

-- Assistant Chief Financial Officer for Examinations responsible for all federal pre-audit functions including, but not limited to, the pre-auditing of select vouchers and contracts; the custody of processed vouchers, checks and contracts; and the performance of liaison functions with the General Accounting Office of the current United States Comptroller General;

-- Assistant Chief Financial Officer for Legal Functions, or the chief legal counsel, with all requisite functions and authority thereof, for the federal Chief Financial Officer.

It should also be emphasized that the explicit duties of a federal Chief Financial Officer and his administrative structure should not add to or become an additional bureaucratic layer of government. As I envision it, the Chief Financial Officer would assume the fiscal control and management functions of the Financial Management Service of the United States Department of Treasury; the Office of Information and Regulatory Affairs in the Office of Management and Budget; and the Office of Federal Procurement Policy in the Office of Management and Budget. These functions at present are secondary in importance within the respective operations at the United States Treasury and Office of Management and Budget.

-- Explicit pre-audit authority, or ensuring that each federal contract and voucher undergoes a proper pre-audit by personnel of the appropriate governmental branch entity or by the Chief Financial Officer. The on-going experience of various states proves that this is a valuable tool in saving the government money BEFORE it is spent. And as Senator Roth wrote in a slightly different context, "a major structural impediment to effective controls on waste, fraud and abuse is the lack of effective mechanisms for preventing fraud and mismanagement in most federal agencies."

-- Federal Finance Council: I propose this council to identify financial management objectives and information requirements through the cooperative efforts of the Chief Financial Officer, the United States Comptroller General, the Director of the Office of Management and Budget, the Secretary of the Treasury, and the Director of the Congressional Budget Office. In essence, these fiscal management officers would work toward an amenable and agreed-upon change-over to a uniform federal accounting system. The general public, private sector representatives and interested elected officials should also have input into this process through the creation of an Advisory Board to this Finance Council.

-- Accountability To The Public: Consistent and sound fiscal information is urgently needed within the federal government and the Roth bill allows for a wide variety of such reporting features. But the bill does not explicitly address the need to better acquaint the American public as to the extent and control of federal fiscal operations. The Chief Financial Officer should fill this information vacuum; this office should serve as a prime source for financial information to the American public through the development of a comprehensive annual report based upon generally accepted accounting principles (GAAP) and supplemented by monthly reports devoted to itemizing financial transactions and possibly research articles of general interest.

Most of my proposals are currently not features of this Roth bill under discussion to establish a Chief Financial Officer for the United States of America. As worthy as the committee's efforts are in bringing about the creation of this office, I believe my suggestions would provide for a more effective mechanism for achieving the goals of this bill. Rather than create a Chief Financial Officer buried within the on-going federal bureaucracy, an independent Chief Financial Officer would bring about, to paraphrase your Chairman, far-ranging and fundamental changes in federal fiscal management. This independent agency would not only allow for consistent fiscal controls to be applied to the federal government for the first time in history, but would bring about the uniformity in financial management called for almost four decades ago with the passage of the Accounting and Auditing Act of 1950. As I have already said, the American taxpayer should expect no less accountability by the federal government as it expends their hard-earned tax money.

As President of the National Association of State Auditors, Comptrollers and Treasurers, I am pleased to take note of the bill's inclusion of the recommended language contained in the Memorandum of Understanding governing the exchange of funds between the federal government and the states. Our Association's participation in the State/Federal Cash Management Reform Task Force illustrates our desire to cooperate with government at all levels to bring about fiscal reform. We, of course, offer our services to this committee as it works on this important piece of legislation.

May 13, 1986

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STATEMENT OF LESTER E. HAMMAR

ON BEHALF OF

THE COMMITTEE ON GOVERNMENT LIAISON

OF THE

THE FINANCIAL EXECUTIVES INSTITUTE

REGARDING

S. 2230, FINANCIAL MANAGEMENT REORGANIZATION
AND COST CONTROL ACT

BEFORE THE

COMMITTEE ON GOVERNMENTAL AFFAIRS

UNITED STATES SENATE

MAY 13, 1986

HEADQUARTERS 10 MADISON AVE BOX 1938 MORRISTOWN NJ 07960 • 201 898 4600

Good afternoon. Mr. Chairman and Members of the Committee, my name is Lester E. Hammar. I am the Vice President and Controller of Abbott Laboratories located in North Chicago, Illinois. However, I appear before you today in my capacity as a member of the Committee on Government Liaison of the Financial Executives Institute.

As you may know, the Financial Executives Institute (FEI) is a professional business organization of individual members who are senior financial and administrative officers in business organizations throughout the United States. FEI has over 13,000 members who are affiliated with some 6,000 companies in virtually all segments of the economy and who, therefore, represent a broad cross-section of American business. The Committee on Government Liaison, one of the technical committees of the Institute, is authorized to formulate statements and positions on federal legislative, and regulatory proposals that are clearly relevant to the responsibilities and interests of the financial executive.

Mr. Chairman, we appreciate this opportunity to appear before the Committee today. We do so, however, with some qualifications. Our association is made up of men and women professionals who have made careers as financial executives. We offer to you the combined expertise of our membership. As financial officers in the private sector, we have far less exposure and experience with the public side of financial management, but that does not mean that we are not cognizant of many of the differences that characterize our respective systems. It must be noted however, that there are some fundamental principles of financial management that are not unique to either sector. In the interest of time, my statement will be limited to Subchapters II and III of Title I of the bill.

Mr. Chairman, the Comptroller General and others here today have already cited several studies that indicate the need for improved federal financial management. Therefore, for the sake of being brief, I will not repeat what has already been quoted from those studies. However, one could conclude that there exists a large and growing professional body of opinion that stresses improvement of the Federal government's financial systems is long overdue.

Toward that end, we believe that your bill moves the Federal government closer to the goal of permanent federal financial management policies and practices. By setting federal financial management policies into law, the subsequent strengthening and consistency of policy that would occur would be very beneficial. In addition, the likelihood of confusion because of different federal financial practices between the agencies would be reduced. With a clear set of financial management policies, we believe that it would only be a matter of time before the Federal government would realize significant cost savings.

In the private sector, if a company does not have an integrated financial management/accounting structure that is given top priority by management, the company will soon be filing

. . .

Chapter 11. In fact, even though I do not have statistical data to support this, I would hypothesize that the majority of business failures in the private sector result from poor financial management or from the absence of proper accounting controls. The development of financial controls and management systems ensures the efficient allocation and use of resources. If a company fails to integrate its financial management/accounting structure into the overall company organizational matrix or fails to grant this function the stature which it deserves, the company's potential for success will be substantially impaired.

As businessmen, financial controls tell us where we are, where we are going, and what it is we are doing, right or wrong. Without these systems, we would have no point of comparison from which to judge the efficiency and effectiveness of our resource management. This concept is best illustrated by example. Suppose a company had ten subsidiary companies that collected and reported financial information in ten different ways, without the parent company having the ability to pull all of the subsidiary information together on a consolidated basis. The result would be unreliable, incomparable data that would make it next to impossible to financially coordinate and manage the activities of the group as a whole. The Securities and Exchange Commission has regulations that guard against this kind of financial chaos. Herein lies the role of the financial executive. Our role as financial executives is that of assuring adherence to appropriate internal controls, generally accepted accounting principles, and SEC rules and regulations. The need for and implementation of these policies and standards is unmistakably clear both in the public and private sectors..

Now Mr. Chairman, as I stated earlier, I will briefly address the financial management provisions of S. 2230--specifically Subchapters II and III of Title I. In short, the financial management provisions you have enumerated in these subchapters appear to us to be complete. We specifically like the creation of an Office of Financial Systems. The Office and its scope are consistent with those we have found to be most effective in organizing ourselves in the private sector.

Your bill provides the Office of Financial Systems' Administrator with a four-year term of office and places the office's location in the Executive Office of the President (EOP). We like the positioning of the Office in the EOP as a means of providing the Administrator closer contact with the President. In addition, we like the term of office provided for in your bill. Four years, we believe, is the minimum acceptable number of years that the Administrator should serve. Any longer term of office would have to be balanced with political considerations that I will leave to you and your colleagues to negotiate.

Finally, we also like the idea of creating agency controllers that will have dotted line responsibility to the Administrator. This is consistent with the private sector structure and has been proven to encourage good financial controls and practices. This is a concept we wholeheartedly endorse. Additionally, we support the bill's provision which allows the Administrator to "sign off" on the approval of agency controllers. This is very important if the Administrator is to have the kind of leverage you've heard some of us mention today.

Mr. Chairman, I have discussed some of the key points of your bill which we support. There are, however, a couple of recommendations we would like to make in an attempt to further strengthen S. 2230.

We have neglected, as you have no doubt noticed, to discuss the 'macro concept' of your bill--the concept of creating an Office of Federal Management. The reason why we have not done so is because we are not experts on the particulars of public administration. However, it is our opinion that the creation of an Office of Financial Systems within an Office Federal Management will not achieve the reforms outlined in your bill. In the private sector, the Chief Financial Officer reports directly to the Chief Executive Officer. This close relationship ensures that the CFO's initiatives are given priority by those who must implement the company's financial policies. Therefore, we recommend that you elevate the Office of Financial Systems to a level equivalent to that of the Office of Federal Management.

An additional point that we would make seems to be taken care of in your legislation--but we mention it only for caution's sake--if for no other reason. The Administrator of the Office of Financial Systems and the agency controllers must be given sufficient flexibility to perform their respective duties. Your bill seems to be sufficient in this regard. However, we just note this for you in the event--and we hope that it is the case--that when your bill starts to move along the legislative path toward enactment, that the Administror and the agency controllers maintain the broadest possible scope of financial management responsibilities, so as to ensure that they do not hide behind a job description that is too narrow.

I have one final point Mr. Chairman. Please try to keep the Office of Financial Systems relatively small. The Office should not be so small that it is rendered ineffective by its lack of resources and staff. On the other hand, the Office should not be so large that it loses sight of its original goal.

In conclusion, Mr. Chairman, we appreciate what it is your are attempting to accomplish with this bill. We support you in this very worthwhile endeavor. However, we believe that your focus should be on elevating the financial aspects of your bill. In so doing, you will set into motion the tools for greater management oversight of increasingly scarce government resources. Only in this way can we be assured of getting all the government services that we are truly paying for. I would be happy to answer any questions that you might have at this time. Thank you.

TESTIMONY BY

EDWARD J. MAZUR
COMPTROLLER
COMMONWEALTH OF VIRGINIA
AND
CO-CHAIRMAN OF THE
STATE/FEDERAL CASH MANAGEMENT
REFORM TASK FORCE

SPEAKING ON BEHALF OF
NATIONAL ASSOCIATION OF STATE
AUDITORS, COMPTROLLERS AND TREASURERS

BEFORE THE SENATE COMMITTEE ON
GOVERNMENTAL AFFAIRS

MAY 13, 1986

MR. CHAIRMAN, MEMBERS OF THE COMMITTEE, my name is Edward J. Mazur. I am the Comptroller of the Commonwealth of Virginia and Co-Chairman of the State/Federal Cash Management Reform Task Force. My comments today will focus primarily on the intergovernmental financing portions of S.2230. These provisions are contained in Title IV, dealing with cash management.

It is with particular pride that I address your committee today, because the bill before you embodies concepts agreed to by the Cash Management Task Force after three years of striving to develop a fair approach to the exchange of funds between the federal government and the states. I urge you to approve these concepts.

Serving on the Task Force has been a heartening experience. It has given me a rare opportunity to work in a very concrete and specific way with other people who are committed to sound intergovernmental relations and to the all-too-abstract concept of "good government."

The federal co-chairman of the Task Force, John Lordan, Deputy Associate Director for Financial Management in OMB, deserves much of the credit for our success in developing an equitable approach to intergovernmental cash management. Speaking for the other eleven members of the Task Force, I can say that we were each encouraged by our potential for making a difference. We knew we could make a difference because the right people wanted something done about cash management. Mr. Chairman, by introducing S.2230, you have made your desire for equity known. In addition, Senator David Durenberger and his staff were instrumental in the creation of the Task Force and have monitored our work. Treasury and OMB have been flexible and enthusiastic, and our state members have worked long and hard in the pursuit of equity.

The concepts approved by the Task Force, and contained in S.2230, are designed to make sure that there are no winners and no losers in the exchange of funds for joint state/federal programs. Simply stated, the policies contained in the bill say that both the federal government and the states will strive to minimize the time between the transfer of funds to the states and the time when the funds are needed by the states. To encourage compliance with these policies, the bill provides for the federal government and the states to pay each other interest. The mechanism for paying interest is created by establishing the Intergovernmental Interest Fund. I want to stress that the interest fund should not be the cornerstone of the Cash Management provisions before you. Instead, the cornerstone should be equity. The interest fund is simply designed to be an incentive for one level of government to be evenhanded in its fiscal dealings with another level of government. In its work, the Task Force tried to remember that the same taxpayers fill federal and state coffers, and our primary objective was to serve them well.

I am confident that the policies and procedures outlined in S.2230 will result in a more efficient, effective and equitable intergovernmental exchange of funds. The procedures set out in the legislation have been tested by four states, and were recently fine-tuned through a rigorous dialogue between Task Force members.

In considering S.2230, it might be helpful to have a little background on how some of the key concepts evolved. The State/Federal Cash Management Reform Task Force was established three years ago, largely in response to state and congressional concern over federal agency implementation of the delay of drawdown funding technique. Under the delay of drawdown technique, the state's drawdown is spread out over a number of days so that daily deposits will roughly coincide with the pattern in which checks have historically been presented to the bank for payment. The delay of drawdown technique was inconsistent with some state statutes and constitutions because states could not necessarily comply with the requirement that funds be available before checks are written.

But the delay of drawdown technique was not the only impetus for creating the task force. A number of studies, like the Grace

Commission report, looked at financial transactions between the federal government and the states and found that some states were drawing down federal funds prematurely. In 1981 and 1982, the Joint Financial Management Improvement Program (JFMIP) reviewed most of the financial transactions between the federal government and four states. During the same period, four additional states conducted self-evaluations using the JFMIP approach. These studies, involving a combined total of eight states confirmed that, for some programs, states did draw down federal funds prematurely. These studies also found, however, that states were inadvertently being asked, for some programs, to use their own funds to support federally-assisted programs while awaiting the arrival of federal funds.

Since its inception in February, 1983, the Task Force has been working to develop and test techniques for the equitable exchange of funds between the federal government and the states. In June, 1983, the Task Force members signed a Memorandum of Understanding consisting of 17 policy statements governing intergovernmental financial transactions. Four states--Virginia, Indiana, Wisconsin and California--conducted pilot tests of techniques that had been set out in the MOU for exchanging funds. In general, the pilots improved the flow of funds between the federal government and the states involved. It is clear that progress among the pilot states was directly the result of cooperation between the participating states and the federal departments and agencies involved in the pilots. For example, many participating federal agencies have been very helpful in changing procedures that usually hinder the flow of cash to the states.

By the same token, pilot states worked diligently with their program agencies to make sure that cash was drawn down as close as possible to the time it was needed. The pilots demonstrated that, in a model situation, cash can be handled in an expeditious manner acceptable to both the federal government and the states.

In November, 1985, a second MOU was signed. This new MOU restates support for the 1983 MOU and supports the concepts in the bill before you, along with administrative regulations and other guidance compiled by the Task Force. The new MOU is true to the Task Force's goal. It strives to assure that there are no winners and no losers when funds are transferred between the levels of government. Further, these documents seek to remedy a number of equity issues that were raised by states during the course of the pilot tests. While these equity issues were not technically part of the policies being tested by the four pilot states, it quickly became apparent that these issues, if unresolved, would continue to present serious problems in the flow of funds to the states. For the most part, these equity issues are dealt with in either the legislation and its interest fund, the draft regulations we developed, or in the associated guidance.

To a large extent, the equity issues identified by states deal with federal action or inaction that results in a state having to use its own funds to support federal programs. States, for instance, often have to use their own funds to help carry out a federal program because the federal agency disputes a claim or defers or disallows a state cost.

In other instances, a delayed appropriation by Congress or an inadequate grant award by a federal agency may force states to pay for a federal program with its own funds. In response to state concerns with the award process, the Task Force agreed that the Department of Health and Human Services should test an annual grant award process in a number of states. It was hoped that this process would alleviate the red tape and potential funding shortfalls that states sometimes encounter on a quarterly basis. Further, difficulties arise when the federal government rescinds previously promised funding or denies funding for previously approved activities or costs.

In a slightly different vein, states also cited problems created by the inconsistent interpretation of federal regulations by federal employees. The interpretation may vary between the regional and national levels of the same agency, or may vary between different federal agencies.

While some of these issues might be resolved by authorizing the federal governments and the states to pay each other interest, others may require basic changes in federal program administration and management.

I also want to mention that much has already been done to apprise federal and state officials about the work of the Task Force. OMB and Treasury have been in touch with federal agencies on an ongoing basis, and the "Intergovernmental Financing Act" was submitted in the President's 1987 budget as part of the Administration's Management Improvement Program. In addition, OMB circulated the concepts developed by the Task Force to all federal agencies for their review and comment. Further, state fiscal officials have been given periodic updates on the Task Force's efforts. The National Association of State Auditors, Comptrollers and Treasurers, and the National Association of State Budget Officers have both adopted resolutions supporting the work of the Task Force.

At its most recent meeting, conducted in Washington in March, the Task Force decided that it is time to start involving states in a more formal or structured educational process. The first step in this process will probably be a conference for states in Washington this summer. The purpose of the conference would be to discuss new cash management policies, the legislation before you, the draft regulations and the new funding technique that was pilot-tested by the states.

In conclusion, I would hasten to add that this legislation can do much to build the level of confidence and trust that one level of government places in another, because it is based on a set of carefully scrutinized, tested and equitable principles. Further, it deserves special note that the unusual structure of the Task Force was conducive to success. The Task Force has been co-chaired by a federal representative and a state representative. It has been staffed by both the U.S. Treasury and the National Association of State Auditors, Comptrollers and Treasurers. We have met at least quarterly and we have based our discussion on a mutually agreed-upon agenda. I am unaware of any other task force that has been structured or staffed in this way. It is a good approach. I recommend that it be used as a model for dealing with other intergovernmental priorities.

Remarks of Professor Murray Comarow
Before the
Senate Committee on Governmental Affairs
William V. Roth, Jr., Chairman
May 13, 1986
On S. 2230, the Federal Management Reorganization
and Cost Control Act of 1986

Thank you, Mr. Chairman, for the privilege of submitting my views on this vital bill. As agreed with Robert Gilmour, I will make a few brief remarks, outline some areas into which the Committee may wish to inquire, and respond to the Committee's questions.

My remarks today are confined to Title I of the bill, which would establish an Office of Federal Management in the Executive Office of the President and redesignate OMB as the Office of Federal Budget. With one exception, I strongly endorse Title I in general, and the functions set forth in section 903 in particular. The exception is that part of section 903(a)(9)(B) which would have the Director of OFM advise the President ". . . on the qualifications of candidates" for presidential appointments.

As the Executive Director of the Ash Council* in 1969-1970, I played a part in the transformation of BoB into OMB. The driving principle behind this effort may be derived from four sentences in the Council's first recommendations to the President

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* The President's Advisory Council on Executive Organization. Chaired by Roy L. Ash, members were Dr. George P. Baker, Governor John B. Connally, Frederick R. Kappel, Richard M. Paget and Walter N. Thayer.

(memo of August 20, 1969):

> Abstract organizational principles, per se, have little value. The challenge is one of reducing to human scale the task of coping with the nation's most pressing and changing needs. The only way to meet this challenge is through greater reliance upon the agencies. The prerequisite is dramatic improvement of the management processes of the Executive Branch, with leadership from the President's office.

In my opinion, the effort failed. The management function, despite administration denials, has never become a significant force in OMB.

Had I the gift of foresight, I would have recommended--and I expect the Council would have agreed--a separate office of Federal Management, similar to that contemplated in Title I of this extremely professional and thoughtful bill. (The Committee may be interested to know that the Ash Council's original name for the new BoB was "The Office of Executive Management.")

Yet I do not believe for a minute that passage of S. 2230 will necessarily accomplish its goals. Presidential indifference, much less hostility, could well reduce the impact of the new office to a minimum. I believe it is a worthwhile effort, however, because it could create a new dynamic. Given leadership and resources, it can become, in time, a constant force for management improvement--mostly by the agencies themselves.

Some areas the Committee may wish to explore include these:

1. What can any reorganization really accomplish? Doesn't management depend primarily on people?

2. What does "management" mean within the Executive Office of the President? Efficient use of resources? Control of the system for political ends?

3. What effect did the introduction of a layer of political appointees at OMB top levels have on the culture of the organization?

4. Why hasn't BoB/OMB ever done the management job mandated by section 209 of the Budget and Accounting Act of 1921?

5. Does it make sense to separate "management" from "budget?"

6. President Nixon said that ". . . preparation of the budget as such will not be [OMB's] dominant, over-riding concern."* Yet it was. Why?

7. Is there any chance that future administrations will reverse the trend observed in the Carter and Reagan years away from "neutral competence" to management control by administration loyalists?

Thank you again for this opportunity.

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*Message to the Congress of March 12, 1970 forwarding Reorganization Plan No. 2.

STATEMENT OF
PROF. CHARLES F. BINGMAN

SCHOOL OF GOVERNMENT AND BUSINESS ADMINISTRATION
THE GEORGE WASHINGTON UNIVERSITY

BEFORE THE
SENATE GOVERNMENT AFFAIRS COMMITTEE

S. 2230

A BILL TO IMPROVE THE MANAGEMENT OF THE FEDERAL GOVERNMENT BY ESTABLISHING AN OFFICE OF FEDERAL MANAGEMENT AND FOR OTHER PURPOSES

MAy 13, 1986

Mr. Chairman and members of the Committee:

It is an honor and a privilege to appear before this committee to give you my views on S. 2230, "a bill to improve the management of the Government by establishing an Office of Federal Management in the Executive Office of the President, and for other purposes."

First of all, let me say that my own experience includes more than five years in OMB in the period of 1971 to 1976 as Deputy Associate Director for Organization and Special Studies. During that service I gained a great respect for the organization and for its values as an agent of the Presidency. But I felt then as I do now that the management role of OMB had not reached its full potential; and having also spent 26 other years in the Federal government outside of OMB, I was aware of how many tough and important management problems were being faced in the agencies for which OMB provided little help and was often a hindrance.

I joined OMB the year after its creation, when the going was good and there was still the feeling that the new organization was going to restore the reputation of the old Bureau of the Budget as a leader and driving force in the management affairs of the government. But I was also there as that hope began to fade, and the realities of the preoccupation with the budget began to take over. Ever since that time, I have felt it urgently important that a new and better effort be undertaken to create the real management leadership institution which the government badly needs. I believe that S. 2230 is the heart of that new and better effort.

Let me say at the start that I fully agree with the creation of an independent Office of Federal Management. I am one of those who supported the creation of OMB, but after 16 years of hoping and expecting, I have come to recognize that the combination of budget and management is a weakness rather than a strength, and the creation of a separate management organization has moved from a possibility to an urgent necessity.

I have prepared a brief report, Mr. Chairman, which, with your permission, I would like to submit for the Committee's information in which I outline why I believe that the OFM is needed and what its roles and objectives might be. Despite the wealth of other valuable material in S. 2230, I would like to confine my brief remarks here to the Office of Federal Management and why it would be a significant advance over the current management role of OMB.

I believe that there are three major ways in which a new and more effective OFM could achieve the stated purpose of this bill to improve the management of the Federal government"

First, it will serve the President better.

The creation of the OFM would give the President two strong elements in the Executive Office of the President, and I think that's a big plus. I don't subscribe to the argument that OFM would be "just another piece of bureaucracy". I think that, when it comes to the managment of the Federal establishment, and the role of the President as manager of the government, he needs all of the help he can get. An Office of Federal Management, properly designed and properly led, can make an enormous difference to the President and to the government in attacking the serious management problems which are every day more apparent.

In addition, I think that the OFM will serve the Presidency better. I fully understand the need for the incumbent President to have staffs and people who serve him, but there is the added necessity for a more permanent, stable organization which can preserve the longer term management improvement and management reform efforts of government, and assist each new President coming to office to understand that agenda and give it support.

Second, Mr. Chairman, OFM can and will provide greater leadership and leverage for improving Federal management.

Time permits only the mention of the most important ways in which I think this will happen:

1. The Director, OFM, will almost certainly be able to get more direct Presidential attention on managerial problems, and in a more disciplined and effective way.

2. Freed from the tyranny of the budget, the OFM will become more assertive and independent in shaping an agenda of management reform and pressing it home.

3. Also because of its release from the budget, OFM can establish a new and more wholesome relationship with the departments and agencies, and provide more positive, constructive assistance to agency=based efforts to improve management -- what I call "turning on the talent base".

4. I want to applaud the way in which S. 2230 lays out in detail the specific management roles which the Congress expects the OFM to fulfill, because I believe that one of the failures of OMB is that, at any given time, it has ignored many important management responsibilities. With a statutory mandate to live up to, OFM will be a more complete and comprehensive force for management improvement, because it will not be able to ignore or undervalue important management activities.

5. OFM will be more accountable within the Executive Branch, both to the President, and to the departments and agencies. OFM should be a better planner and strategist in the managerial arena, and a more reliable partner throughout government on long term reforms and initiatives.

Third, I believe that the OFM will enhance management accountability to the Congress.

I believe that OFM will be able to provide the Congress with better management recommendations to consider; more technical competence and assistance in the difficult business of assessing agency performance, and recommending solutions; OFM can be of direct assistance to the Congress in drafting legislation, or advising on drafts originating in the Congress. OFM will, I hope, reinstitute a highly effective legislative review and clearance process within the executive branch; and it will represent a clearer, more comprehensive point of liaison and working relationships with the Congress on management matters.

I would like to wind up my testimony, Mr. Chairman, with four specific recommendations which I believe would strengthen S. 2230 and give OFM the best possible chance:

1. I believe that it is a serious mistake to mandate subsidiary organizational elements in statute, and I will simply say that I agree fully with the points made Mr. Kline of the National Academy of Public Administration on that score.

2. S. 2230 calls for an annual managment report to be made by OFM. I strongly urge the Committee to upgrade that to the mandating of a Management Plan. One of the tyrannies of the budget process was that it tended to subvert and undercut management planning. I believe that OFM should direct the preparation, government-wide, of a 3-5 year management plan which shows specifically what management problems are occuring, and how agencies propose to solve them. This Plan can become the strong centralizing force which brings management improvement together. It is also a superior way for the Executive Branch to be accountable to the Congress. I think

would benefit from seeing such a Management Plan which it can agree with or amend, rather that scattered bits and pieces of reform which fail to give the Congress a comprehensive understanding of what is going on. I venture to suggest that agencies would welcome such a comprehensive approach to management rather than resist it.

3. One of the worst failings of OMB is its complete failure to take a leadership role in the Federal government to generate innovation, adopt new management systems and techniques, and sponsor or generate management research or test and demonstration programs. I think that this Committee could be a great assistance by making it clear that it recognizes the value of such research, authorizes OFM to sponsor research and demonstratrion programs, and authorizes the appropriation of funds for that purpose to OFM.

4. One improvement which has been introduced into OMB in the last two years is the process of having a government-wide management review as an integral part of the budget reviews conducted for the Director of OMB in the spring and fall. This committee may wish to consider mandating the continuation of these management reviews as part of the budget process, but with the Director of the Office of Federal Management making the presentation to the director of the budget office.

Mr. Chairman, this concludes my remarks! I do have some more technical points which I would like to offer to your staff, and I would be glad to attempt to answer any questions which you and the committee wish to ask. Thank you.

A PROPOSAL FOR CREATION
OF THE
OFFICE OF FEDERAL MANAGEMENT

prepared by
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I. WHY AN OFFICE OF FEDERAL MANAGEMENT IS URGENTLY NEEDED

For a number of years, the National Academy of Public Administration (NAPA) and others have been increasingly more urgent in pressing the view that the Federal government is failing to keep the management of its programs up to adequate standards of performance effectiveness, and is no longer providing fully effective service to the public.

As used in this report, Federal management means the whole vast array of Federal organizations, personnel, facilities, systems, regulations, and processes which are used to direct the Federal government's programs and supporting activities. As an operating entity, the Federal government dwarfs even the largest of private sector companies. There are 4.6 million Federal employees, including the uniformed military services. Federal land and structures are valued at $ 104 billion, and by any conservative estimate, are worth far more. In addition to its $ 42 billion in buildings to house its people, the government leases 83 million square feet of additional office space. It spends more tnan $ 160 billion per year on goods and services, and administers almost 19 million procurement contracts.

Maintaining this vast public establishment is, in itself, a management responsibility of staggering dimensions. But more importantly, these resources are crucial to the management of Federal programs -- everything from national defense and foreign policy, to national programs for health care, social security, housing, environmental protection, highways, and space exploration. These Federal programs impact almost every American citizen, state and local government, and private corporation. The question of how well the Federal government manages its affairs has become a matter of crucial national concern.

In its recent report entitled "Revitalizing Federal Management", a panel of the National Academy of Public Administrations stated:

> "The Federal government has been a growth industry over the last thirty years, and Federal managers have had to accomodate to an unprecedented increase in the range and complexity of their responsibilities. Dozens of new programs have been created and new organizations established to run them, including five new Cabinet departments. More new regulatory programs have been initiated in the last thirty years than in any other comparable period in national history. The Federal government now manages - either

> directly or indirectly through grants and contracts -- some of the most important and complex enterprises in the world. This is a world where management is vitally important and the public expects and demands good performance. Despite often valiant efforts to solve specific management problems, the last decade has been a period of declining managerial effectiveness in the Federal government. Efforts at improvement have been increasingly sporadic, poorly planned, and inadequately backed and staffed." 1/

Other observers both in and out of government voice this same concern. In a recent article 2/ the Comptroller General of the United States, Charles A. Bowsher said that GAO had "looked closely at the history of centrally directed management improvement programs over the last 10 years. The results were not encouraging. We found a record of periodic initiatives, few of which have made any lasting impact."

The report of the President's Private Sector Survey on Cost Control (the Grace Commission) has given President Reagan a similar view: 3/

> "It is admittedly a staggering task to manage an organization whose size dwarfs even the largest private sector corporations. Still, the Federal government is also an organization with human and financial resources of gigantic dimensions, and it would appear that one Administration after another has simply not been as effective as it should have been in productively employing these resources. The thousands of recommendations of the PPSS attest to the work that can be done -- and needs to be done right now -- to bring the management of the Federal government under control."

The Grace Commission further states that "these deficiencies are not the result of lack of competence or enthusiasm on the part of Federal employees. Rather, responsibility rests squarely on the Executive Branch and the Congress which, in the final analysis, are the joint architects of the Federal government's management systems, policies and practices."

The American public has also become increasingly concerned, and in recent years, has converted this concern into action. In a recent book, 4/ it was pointed out that, since 1977, no fewer than 25 states have enacted new statewide tax or spending limitations, giving permanance by state constitutional amendments and other formal measures limiting future spending growth. These measures have "made it impossible for elected officials to return to business as usual, even if they had been so inclined."

While these measures dealt largely with tax and major pubilc program policy, it is clear that they also reflected public concern over the size, cost, and inefficiency of public institutions.

The Reagan Administration itself obviously shares this concern, and has launched one of the most broad-ranging programs of management reform and improvement in recent history. In its 1985 report accompanying the President's Budget entitled "Management of the United States Government", OMB stated:

> "After decades of sporadic effort, the problem of management systems -- a problem that transcended changing Administrations -- still required urgent attention. There was still no broad program in place to ensure a continued, organized emphasis on managment improvement."

These strong messages cannot and should not be ignored. The government's "deficit" in its own management is getting worse instead of better, and simply cannot be eliminated by its present array of management institutions and systems. The time has come to reexamine the structure and resources available for use in fighting this managerial deficit.

II. THE ROLE OF THE CENTRAL AGENCIES OF THE FEDERAL GOVERNMENT

Responsibility for effective management lies primarily with the departments and agencies, and in the authorities of agency heads. A very large proportion of both problems and cures relate to how well these agencies perform. But it is a fact of life -- and a part of the problem -- that much of the structure and systems of Federal management are highly centralized in nature; that is, the Congress and the President have created powerful central agencies to exert government-wide control over management policy, systems, and practices. These central agencies are the Office of Management and Budget (OMB), the Office of Personnel Management (OPM), and the General Services Administration (GSA). They have been vested with power to deploy and enforce government-wide systems and regulations which, in large part, dictate how -- and how well -- the government manages its programs and meets public needs. This centralization has been traditionally viewed as necessary to provide the President with the resources to exert his leadership as the chief executive of the Executive Branch, and to focus accountability to the Congress on management matters. But it is increasingly clear that neither of these crucial objectives is being adequately achieved. To again quote Comptroller General Bowsher:

> "This record (of failure of the traditional central agency focus) is the result of the inherent limits on what can be done through the efforts of central agencies. Their drawbacks include:
>
> > First, the centrally directed approach causes unavoidable confusion between issues of program policy and program execution. Successful implementation depends on effective management support.
> >
> > Second, the centrally directed approach allows those responsible for day-to-day management of government programs and agencies to escape accountability for the results of their actions.
> >
> > Third, the centrally directed approach diverts energy and attention from the operating agencies, where the problems really are, and where effective solutions must be found and implemented."

While noting the importance of OPM and GSA, the National Academy's report concentrated on OMB, recognizing that since before WW II, OMB (and its predecessor, the Bureau of the Budget), has been the primary and most influential agency in the arena of government management.

The report states: "The NAPA panel has been forced to conclude that the Federal government's pressing needs for broad-based and sustained management reform can best be accomplished by the creation of a new Office of Federal Management (OFM) in the Executive Office of the President, which should become the framework for providing a more powerful and responsive leadership for management reform and improvement for the entire Federal government."

The Grace Commission report to the President arrived at this same conclusion, stating: "PPSS, in analysing Federal government operations and identifying opportunities to cut costs, concluded that a major obstacle to improving the efficiency and effectiveness of the government is the Federal structure itself. PPSS identified the need for a mechanism at the top level of government to provide much greater emphasis on management improvement. Accordingly, PPSS recommended the establishment of an Office of Federal Management in the Executive Office of the President, responsible for policies and programs throughout the government to improve financial management information systems, to coordinate reporting policies and procedures, to assure effective management of human resources, and for planning and budgeting."

The views of the Comptroller General, the National Academy of Public Administration, the Grace Commission, and of scholars in the field, as well as the past attitudes of the Congress, clearly portray the ambiguity which is felt about the role of these cental agencies, and especially OMB. All recognize that these central agencies are a necessary and important element of government and that there are key government-wide management responsibilities which must be exercised by them. These include development and issuance of management policy, certain common management systems, standards for the performance of management functions, and oversight on behalf of the President with respect to agency compliance and performance effectiveness. While the NAPA and PPSS proposals for an Office of Federal Management are very much in agreement in most ways, they differ substantially as to the nature of the role which an OFM should play. In the PPSS proposal, the OFM would add GSA and OPM to the current OMB to produce a single "conglomerate" office of great scope and power. What is far preferable is closer to the model proposed by NAPA which would break out the management oriented roles of OMB to form the new OFM, leaving GSA and OPM as independent entities, as well as a residual presidential budget office under an appropriate title.

The PPSS proposal takes the position that the President is a chief executive officer almost in the corporate sense, and it sees the OFM as exercising even greater central power and authority on behalf of the President. It presumes that OPM and GSA would continue as operators in their respective areas. All policy functions with which these institutions now deal would be brought into OFM's "front office" staff.

The NAPA proposal would continue to recognize the independence of OPM and GSA as well as the central budget office. The panel resisted the urge to propose a single all-powerful institution, even recognizing that its approach to the creation of the OFM would mean that there would be four central agencies rather than three, and that the necessity for coordination of these four institutions would be even greater. Thus, one "power" argument centers around the wisdom of a single all-powerful Presidential agency, or a pattern of four which must work together, and balance each other off.

At the heart of this argument is the issue of the link between management and budget. In the history of the old Bureau of the Budget, and indeed in the creation of the current OMB, it has been argued that this combination woul have great value: that the processes of budget examination would identify many of the problems of government on which OMB's management experts should work. In turn, management reform and improvement ventures would derive their real power and influence from being linked with the budget. It appears that this "power by association" continues to be a major factor in the PPSS approach.

The NAPA panel members, many of whom supported the creation of the OMB, rejected this perception. In its report, the panel stated that "the disabling systemic weakness is that the budget and related national economic issues have usually proved to be all-consuming. In recent years, it has become so intense that it has almost totally preoccupied critical OMB leadership, draining away time, interest, and staff and having a chilling effect on many management initiatives. Therefore, even when an Administration such as that of President Reagan seeks to take the initiative for management reform across a broad front, it finds OMB no longer has the talent base nor the recognized capability for leadership to sustain such efforts."

Nor does it appear likely that, in the forseeable future, the budget preoccupation will decline. Therefore, proposals and arguments for building up and revitalizing OMB's management side seem less hopeful and less realistic.

But the fundamental argument here is also the one raised by Comptroller General Bowsher. The current concentration of strength in the central agencies has not worked. It has not produced effective management, and it has not kept the government up to date with the best contemporary management concepts and practices. It has not even prevented waste and abuse, nor prevented the deterioration of current management capability. The 2478 reform recommendations of the Grace Commission, and the breadth and scope of the Administration's Reform '88 program are serious evidence of the degree to which the Federal government has failed to keep on top of its problems. Further centralist concentration as proposed by the Grace Commission does not seem to be the needed answer, nor is it at all clear whether the Congress, which is itself ambivalent about central Executive Office power, especially in OMB, would be willing to permit such a "super OMB" to come into being to exert even greater contralist authority.

Both Comptroller General Bowsher and the NAPA study report propose a totally different view of the role of the central agencies -- one in which the "center of gravity" of government management reform is at the agency level, and one in which the central agencies function in a way which aids and facilitates the individual and group efforts which contribute to common government-wide solutions. This is decentralization rather than centralization, and it is a realistic recognition that most management issues, good and bad, really must be attacked at agency levels. As stated in the NAPA report:

> " The most powerful answer which the NAPA panel sees to the solution of pervasive government overburden and obsolescence is to create a new environment which seeks to shift the center of concentration and effort for managment reform into the hands of a broad range of senior and mid-level managers and supervisors, and to use the authority of the President and the leverage of the central agencies to motivate this executive/manager level and support its initiatives."

Thus, the critical issues is not whether the central agencies are powerful or not. They are, and will remain so because they must have the capacity to serve the President effectively. If the old forms are not fulfilling this purpose, then it is time to reexamine the organizations which exercise that power.

The Office of Federal Budget which would remain after the removal of the management functions would obviously remain a powerful and valued organization. It would continue to report to the President, and its Director would remain a Level II member of the Cabinet. It's principal role would be as the President's agent and staff capability in the highly complex and sensitive arenas of budgeting, resource allocation, and economic analysis. Budget examiners would continue their assessment of Federal program performance as a vital element in budget formulation and as a source of adivce to the President.

The budget itself would continue to be an important vehicle for management matters, because management reforms require resources or changes in policies which must be reflected in the budget and justified as part of the overall budget review process. Each year, the present OMB conducts spring previews for its director which are broad budget planning frameworks. Then, in the Fall, the budget review provides the director with a vehicle for many final budget decisions. Last year, OMB began a management element in each of these reviews. This management element could be continued and would provide an excellent way to link the OFM and the Office of Federal Budget together.

The Office of Personnel Management and the General Services Administration would continue as independent entities, much as they are now. There are clear advantages in having these organizations in charge of the implementation and operation aspects of their respective areas of expertise, as opposed to complicating the role of the OFM with these operational burdens. OPM and GSA would remain in charge of the development of management standards, policies, performance evaluations and agency oversight for their areas of concern, and each would continue to be responsive to the Congress in accounting for execution of the laws.

But in terms of which institution serves as the agent of the President in developing and directing comprehensive management policies, this should be OFM's role, and it would require that OFM take a leadership role with respect to OPM and GSA, as well as all of the other departments and agencies of the government.

III. THE OFFICE OF FEDERAL MANAGEMENT: ROLES AND OBJECTIVES

Organizational Roles

The Office of Federal Management should be an independent office in the Executive Office of the President, reporting directly to the President. Its Director should be a Cabinet officer at Executive Level II. For those who argue that the budget is the real power base for management concerns, it should be pointed out that, even in the current OMB, it is recognized that the real source of its position is not the budget per se, but direct and continuing access to the President, and real relevance to the President's needs. The importance of budget issues and the need for Presidential response and decision-making is the vehicle for such access and relevance. But the range and importance of management issues are such that they would also assure that same access and relevance. Currently, this right of access is more theoretical than real if the OMB Director is unwilling to invest part of his limited access time on management matters. This relationship with the President would be further assured if the OFM were given responsibility for preparation of Presidential Executive Orders, Proclamations, and other Presidential directives; and for development, review, and coordination of Administration legislative initiatives in the management arena, as OMB ought to be doing now.

OFM's strength would lie in its role as the management agent of the President, and its ability to act on behalf of the President on a broad, government-wide basis. OFM's authority must extend to all government functions, even where principal responsibility rests with other agencies. This is true of OMB now, and it has led to problems of conflict and overlap, but these conflicts are bureaucratically manageable, and are easier to tolerate and deal with than the vacuum of capability which now exists.

OFM's role would of necessity have to be authoritative. Presidents must give orders, and therefore, their agents must be able to promulgate such orders and enforce them. But the whole sense of the preceeding sections of this report is that the entire approach of the OFM must change away from that of OMB if it is to serve the President effectively. OFM must be the catalyst which galvanizes effective management throughout government. More specifically:

1. It must develop and gain agreement in the Executive Branch and the Congress for an overall strategy for its management role and objectives, and the conversion of that role into an agenda for specific management programs and projects.

2. Its role should be truly "executive" -- not just to study or examine, but to create action, primarily thru others, so that the whole Federal establishment is motivated to keep itself up to a high order of management effectiveness. OFM should evaluate the management roles and effectiveness of executive branch agencies so that it can give advice and recommendations to the President on corrections and improvements, but the spirit of that oversight should be positive and constructive rather than negative and punitive.

3. OFM's role should be to facilitate: to instigate, to promote, and to assist, and not primarily to regulate, control, or audit. The Federal government has more than enough audit/regulatory mechanisms and overseers. What it suffers from is not the lack of ability to evaluate itself; it suffers from an inability to take action and to implement change. It has all too few agents that can create sustained and coherent action, and therefore the OFM role in designing and directing action is too precious to be allowed to dissipate into that of another regulator or "watchdog". A serious failure of the central agencies in recent years has been that, in their preoccupation with their regulations, they have been a force for rigidity, entrenchment, and stultification, instead of loosening up the system, dislodging entrenched interests, promoting innovation, and creating the capacity and the will to experiment.

4. Finally, the establishement of the OFM would give the Federal establishment something which we now more clearly see that it lacks -- a full-time, committed, influential organization which is the government's advocate and leader for better management 365 days a year. OFM's Director would have the attention of the President, the Cabinet, and the Congress, and would not be diverted by the budget or anything else. In addition to its appointed political leadership, OFM should have a high quality staff of both career civil servants and others from outside of government, but all of whom are broadly experienced and knowledgeable about government, and able to sustain management reform for the long term. Under a director and a deputy director chosen by the President, OFM should become the major leadership force for restructuring, redesign, and rationalization of the institutional architecture of the Federal establishment.

Specific OFM Management Activities

The array of relevant management activities is very broad -- far greater than is exercised effectively by the current OMB. It includes the following:

1. Government organization matters
2. Staffing and workforce management
3. Procurement policy and systems
4. Financial management systems and controls
5. Human resources management
6. Management information systems
7. Productivity enhancement
8. Cash management systems and oversight
9. Credit management systems and oversight
10. Government capital investment and management
11. Travel and transportation services
12. Intergovernmental relations
13. Paperwork management and control
14. Regulatory review and reform
15. Real and personal property management
16. Management evaluation systems
17. Planning and program management systems
18. Auditing, investigation and inspection
19. Control of fraud, waste, and abuse
20. Grants management systems and techniques
21. Evaluation of agency management performance
22. Reports, statistics and publications policy
23. Privatization and relations with the private sector
24. Management research and demonstration programs
25. Design and development of new management systems
26. Freedom of Information Act compliance
27. Privacy Act compliance
28. Printing and reproduction policy and operations
29. Start-up assistance for new agencies or programs
30. Government corporations and public enterprises
31. Regional and field office organizations

While this listing clearly deals with administrative management systems and procedures, it should be made clear that the OFM role includes the management of Federal programs and not just staff functions. In fact, the primary concern in government should be to improve program delivery, using managment systems and processes to support that purpose, and not as ends in themselves. OFM would evaluate program design, program planning systems, program management techniques, productivity, quality control, and program cost effectiveness. It might be called on to do specific studies and reviews of specific progrm areas such as loan-making or research and development. OFM should be the government's expert on program design and operations and should be able to provide start-up (or phase-out) assistance for agencies or programs. This does not mean that OFM must be staffed with experts on every government program. Rather, it requires generalist talent, capable of evaluating any program, and including epertise in grants assistance, procurement and contracting, loan and loan guarantee programs, and regulations, as well as the government's own direct in-house operations.

OFM Management Tools

For those who may be concerned that the OFM would be powerless without the budget to lean on, a look at the tools which would be available to the OFM will dispel that concern:

Statutory Authorities

1. The Paperwork Reduction Act
2. The Prompt Payment Act
3. The Debt Collection Act
4. The Federal Managers Financial Integrity Act
5. The Single Audit Act
6. The Government Corporation Control Act
7. The Freedom of Information Act.
8. The Privacy Act
9. The Office of Federal Procurment Policy Act
10. The Federal Reports Act
11. And all or parts of many more.

Presidential Authority

In addition to statutory authorities of the kind listed above, the President has issued many Executive Orders or other directives which deal with managment activities within the Executive Branch. OFM would take over the administration of these Executive Orders and directives, as well as the preparation and coordination of future Executive Orders and Proclamations for the President.

Administrative Authorities

The established system of OMB Circulars would become OFM Circulars, except for those dealing with budget matters.

OMB currently conducts a managment review in the spring in conjunction with the budget preview for the OMB Director. This process should be continued with OFM making the management presentation. This process would be a valuable link between OFM and the "price-out" of management activities in the budget.

OFM would also assume responsibility for special authorities such as the procurement policy role of the Office of Federal Procurement Policy,and the regulatory review and the information resources management roles of the Office of Information and Regulatory Affairs.

In addition, OFM would assume primary responsibility for coordination and utilization of the President's Council on

Integrity and Efficiency (PCIE), and the President's Council on Management Improvement (PCMI). These relationships have been given great vitality and scope by the Reagan Administration as a more organized means for coordination of the relationships of the central agencies, and between the central agencies and the departments and other agencies of the Executive Branch. As long as they are available, OFM should be the principal link with them.

One further concept deserves serious consideration. The Federal budget has always served as a general management tool which can be used to explain and justify management needs, plans, priorities, and resource requirements. But the enormous pressures in recent years on the budget has resulted in substantial deterioration of its use as a management planning tool. Therefore, it would be highly desireable to examine the development and use of a Management Plan as an alternative means by which each agency could define its own strategy for achieving management effectiveness and productivity. These Management Plans would also become the basis for oversight by OFM and Congress, and when approved, could serve as a means for evaluation of agency performance. The use of Management Plans would also give greater visability and coherence to management issues and problems and permit management needs to be justified and defended on their merits without being overpowered by budget pressures.

Management Research

There is no arena of management which OMB has so undervalued as that of management research and the conduct of test and demonstration programs. Despite its huge size and vast resources, the Federal government makes pitifully poor efforts toward the conduct of management research, the identification of new management concepts or techniques, or the conduct of management demonstrations or tests aimed at adapting best contemporary management systems and practices into modern public administration. It is not necessary for the Federal government itself to be heavily engaged in management research, since much is being done elsewhere which can be used. But the creation of OFM could be the basis for a whole new and more vigorous program of management research and innovation aimed at maintaining the government's vitality and effectiveness for the future.

Testimony

By

Miner H. Warner

Vice President and Manager

Government Finance Group

Salomon Brothers Inc

On

S.2142

Loan Accounting Reform and Deficit Reduction Act of 1986

Before The

Senate Committee on Governmental Affairs

Washington, D.C. Tuesday May 13, 1986

My name is Miner H. Warner, and I am Vice President and Manager of the Government Finance Group at Salomon Brothers Inc. I have been involved with U.S. Government Agency and guarantee programs since 1971 when I first worked with William E. Simon, subsequently Secretary of the Treasury, in connection with recourse loan sales, such as Farmers Home Administration insured block note and Certificate of Beneficial Ownership sales. I am pleased to have this opportunity, Mr. Chairman, to appear before your Committee to testify in connection with S.2142, entitled "Loan Accounting Reform and Deficit Reduction Act 1986".

Mr. Chairman, the Committee is to be congratulated for dealing comprehensively with an idea whose time has come, namely, the orderly bulk sale of Federal loan assets. The Bill is ambitious and direct. We applaud its direction. In our view the key objective of any such sale of loans on a nonrecourse basis must be maximization of value to the U.S. Government. High cash value for creditworthy assets, not a fire sale, must be the goal. Maximization of value, and privatization of the process, will be extremely beneficial in terms of deficit reduction, a reduced use of Federal credit, and sound management practice.

We summarize our conclusions as follows:

1. In order to maximize value it will be necessary to sell creditworthy loans on an individual program by program basis. Loans originated under different programs and different Agencies cannot be mixed together.

2. Agencies which administer the loan programs, not Treasury, should have primary responsibility for the sales.
3. Loans must be packaged and not sold individually. The negotiated sale method, not the auction method, will maximize value to the Government.

   Only credit enhanced structured financings will be able to obtain investment grade ratings. Without structuring and ratings, packages of loan assets, despite underlying creditworthiness, will be accorded junk bond treatment and be sold at fire sale prices.
4. Third party servicing is available for creditworthy loans.
5. Finally, we strongly urge that not only individual loans sold without recourse but also packages or pools of loans be exempt from SEC registration requirements and in addition from the provisions of the Investment Company Act (1940).

1. FINANCIAL ASSETS

Generally, there are three kinds of loan assets:

(1) Loans which due to their high delinquency and default rates and the uncreditworthiness of their borrowers are unsaleable without recourse. Indeed, these loans were never intended to be of commercial calibre but rather were intended as a modified grant program.

(2) Loans which were intended to subsequently become grants or to have loan terms and conditions modified in the borrower's favor.

(3) Loans created by programs run on commercial lines and characterized by low delinquency rates and low to non-existent default rates.

It is these latter loans, which are sound and creditworthy, which can be structured for nonrecourse sales. Sales can be effectively realized only on a program specific basis--apples categorically cannot be mixed with oranges.

2. AGENCY RESPONSIBILITY

As only specific Agency program loans can be structured and rated, the Agencies themselves should be the focal point in the organization of nonrecourse sales. Agency administrators alone have program specific knowledge which also encompasses the needs and practices of their constituencies. Treasury does not have this program expertise nor expertise in securitized credit-enhanced nonrecourse financing.

OMB and Treasury should be consulted with respect to structuring. Treasury should be consulted regarding the pricing of loan sales and also so as to coordinate the orderly marketing of different loan sales by the different Agencies.

Again because of programmatic knowledge, Agencies should have the primary responsibility, in coordination with OMB, to develop standard contracts and documentation to assist future sales.

3. PACKAGING OF ASSETS: CREDIT ENHANCEMENT

Only fire sale prices can be realized by selling loan assets loan by loan, despite underlying creditworthiness. The market is interested in bulk sales, not a $20,000 loan here by an unknown borrower under Program A which has a 2% program default history, and a $1.150 million loan there by another unknown borrower under Program B which has a .02 of 1% default history. The market is also not interested in pilot sales of various different kinds of loans. Bulk sales of program loans is one precondition to maximization of value.

A second precondition is credit enhancement. Without credit enhancement, packaged loans cannot obtain an investment grade rating regardless of inherent creditworthiness. Without a rating, packaged loans will sell at fire sale prices. Obviously, this minimizes, not maximizes, value to the Government.

Each program will have its program characteristics, not only in terms of delinquencies and default, but in terms of frequency of payment, variations in principal payments, loan underwriting standards, collateral values, remedies against delinquent borrowers, documentation variations. Credit enhancement will vary in response to programmatic characteristics. There is no one "correct" response. Different kinds of enhancements will result in the creation of different market value. Market demand will vary substantially in response to the enhancement characteristics.

A package of securities auctioned on a nonenhanced basis will result in fire sale prices. The kind of credit enhancement techniques used will have a material impact on pricing. Maximization of value presupposes extensive negotiation between the selling Agency, bankers, lawyers, public accountants, third party servicers, the rating agencies, and credit enhancers. A program specific credit enhancement structure, therefore, is the second precondition to maximization of value.

A third and final precondition for maximization of value is a major marketing effort by the committed underwriting banks. Education in depth of investors and a focused and extensive marketing effort is essential for the successful sale of nonrecourse loans. It must be emphasized that this is the start of a major new product area for the capital markets and, by definition, new products are initially unfamiliar ones.

Financial institutions with capital, technology, distribution networks, and in-depth experience with securitized mortgages, receivables financing, and Agency practice as underwriting banks are essential in order to maximize value. There are many major investment and commercial banks which are active in these markets.

4. THIRD PARTY SERVICERS

We are aware of a number of banks and other financial institutions interested and qualified to act as third party servicers for bulk loans sales. Such financial institutions would act as trustee, collection and paying agent, enforce investors' remedies, and also act to advance payments which are delinquent.

The transfer of servicing from the Agency to a private sector third party servicer would reduce the Agency's paperwork burden and free up Agency personnel for programmatic or other responsibilities.

5. EXEMPTION OF NONRECOURSE LOAN SALES

We recommend that the proposed exemption on nonrecourse loan sales from registration under the Securities Act of 1933 and the Securities Exchange Act of 1934 be expanded to include exemption from the Investment Company Act of 1940, and that pools or packages of such nonrecourse loans be excluded also.

As an Appendix to my testimony, I have included proposed changes to S.2142 to reflect the above testimony.

Nonrecourse loan sales can and should be implemented. OMB, of course, has called for them in the 1987 Budget, and we are in regular contact with various Agencies and OMB with respect to nonrecourse loan sales from existing Agency portfolios. If structured properly, and on a programmatic basis, we state with great confidence that loan sales will receive broad market acceptance and the Government receive maximum cash value.

Mr. Chairman, this concludes the formal part of my testimony.

APPENDIX A re: Proposed Changes to S.2142

Sec. 4 (a)	Loans should remain at the originating Agency and be sold by that Agency.
Sec. 4 (b)	The Agency will develop standard contracts taking into account its programmatic goals in consultation with OMB.
Sec. 5 (a)	There should be no requirement to sell loans within 90 days of origination. There should be a requirement to sell substantially all loans created during the fiscal year in that fiscal year. No requirement to sell loans when, in the judgement of the Agency and OMB, inadequate value will be received. No requirement for an auction. Stated objective of this part of the Act should be to maximize value to the selling Agency.
Sec. 5 (b)	Delete this section. No limitation on pooling.
Sec. 5 (d)(1)	Delete as Agency will organize the sale.
Sec. 5 (d)(2)	Standard contracts will be developed on a program by program basis by Agency in consultation with OMB.

Sec. 5 (d)(3)	Delete. The Agency will report to OMB and Treasury on loan sales which in turn will report such sales with analysis to Congress.
Sec. 7	To the extent possible third party servicers will substitute for the Agency in servicing of sold loans.
Sec. 8	Exemption to include pools or packages of loans and include exemption from the provisions of the Investment Company Act of 1940.

PREPARED STATEMENT OF CHRISTOPHER L. SNYDER, JR.

TESTIMONY TO SENATE COMMITTEE ON GOVERNMENTAL AFFAIRS

Do Commercial Loans Have Market Prices?

May 13, 1986

Good afternoon Mr. Chairman and members of the Committee. I'm honored to have the opportunity to speak before you. My name is Christopher L. Snyder Jr. and I am President of Loan Pricing Corporation.

BACKGROUND

The perspective I am presenting for your consideration reflects Loan Pricing Corporation's focus as a collector and provider of commercial (or business) loan pricing information.

Our experiences may shed light on how to develop market prices for different forms of Federal credit assistance.

Loan Pricing Corporation provides banks and other organizations with competitive pricing information for the $500 billion of loans on the books of U.S. banks. These funds are borrowed by more than 50,000 businesses. To obtain pricing information, we conduct monthly pricing surveys among the banks. We also rely on daily pricing information from the corporate bond market. The pricing data supports a Loan Pricing Matrix, which provides prices for borrowers segmented into 128 industries, 6 sales classes, 9 risk classes and other factors.

Possibly this new pricing tool could be applied to some classes of Federally assisted credit.

PRICING MIDDLE MARKET LOANS

This new loan pricing service helps bankers price loans more efficiently. There appears to be a fundamental difference in the way the corporate treasurer and the bank lender approach the negotiation of the corporate loan, especially a loan to middle market companies with sales between $5 - $125 million.

- o Corporate Treasurers Shop Around -- Most borrowers have a rough idea of the current market price for a loan to their type of company before they sit down with the lender to negotiate.
- o The banker is at a relative disadvantage. The bank has no way to develop a clear notion of the "market" price. The banker cannot contact other banks, so he/she must negotiate, striving for the "best" deal.

Deprived of market pricing information, our pricing data suggests that bankers are not very "efficient" pricers. That is, bankers submit widely different prices for similar credits. This is not surprising. It is also not surprising that corporate treasurers take avantage of bankers' lack of pricing information, picking through the banks to find the lowest price. Exhibit 1 illustrates the pricing range that Loan Pricing Corporation typically finds.

To quote one bank, "We never know how much we left on the table. They [the treasurers] tell us how much we lose by, but not how much we win by."

ARE THERE CHANGES AHEAD IN CORPORATE LOAN PRICING?

Several interesting and important changes may be occuring in how business loans will be priced.

Loan pricing may become more efficient. The availability of data on competitive market prices will help. But, the new proposed capital requirements coupled with worsening competition are causing banks to experiment with selling loans. The possible future existence of secondary market prices for corporate loans may have a wide ranging impact on primary market loan prices.

1. Better Alignment with Bond Prices -- If bankers develop a secondary market for commercial loans, relative loan pricing by industry may come into more efficient alignment with relative bond yields by industry. Exhibit 2 presents some details on this.
2. Better Diversified Loan Portfolios -- An active secondary market for corporate loans will permit banks to unhinge their loan origination function from their loan portfolio function. This will give banks the opportunity to diversify their portfolios. Portfolio diversification will minimize the "systemic" problems that contributed to the agricultural and energy bank problems.
3. Moral Hazard and the Market Mechanism -- These changes raise important questions about the "moral hazard" involved when a bank sells a loan. However, the market mechanism may produce some real incentive for a bank to avoid selling a bad loan and ruining its secondary market standing.
4. Marking Loans to Market -- One consequence of the availability of actual market based loan prices will be that banks will be able to "mark their loans to market" each day. Security analysts, some of whom today view banks' commercial loan portfolios as a sort of

murky industrial conglomerate may be very interested in the earnings implications of marked to market loan portfolios. Today, bank stocks P/E's trade at only 75% of the S&P 500. This makes equity expensive for banks. It is possible that marked to market information may cause the stock market to boost the P/E of the better banks. This development in turn would make equity cheaper.

5. Broadly, banks appear to be entering a period of asset/liquidity management wherein all assets that can be sold will be.

I have provided several exhibits and an extended text that touch on these points.

Thank you.

Exhibit 1

Pricing Individual Loans

"All-in Spread"

	Average of 20 Lenders	Pricing Range High	Pricing Range Low
Radio Broadcasting	P + 163	P + 250	P + 76
Small Phone Company	P + 107	P + 125	P + 79

Bankers are inefficient pricers. Surveys by Loan Pricing Corporation show that a corporate treasurer can gain real advantage by shopping around.

Twenty bankers were asked to price out carefully constructed "hypothetical loans" shown above. The banker reviewed complete financials and a business-statement. While the bankers generally agreed on the risk levels of the loan, the table shows they disagreed widely on price -- by as much as 50% in some cases.

In the Radio broadcaster case, for instance, the lending spread was P + 124 with a 25 point facility fee. When combined with a 50% utilization rate, this yielded an "all-in spread" of 163 basis points relative to prime. But the highest bank priced the loan at P + 250 while the lowest was P + 76.

Little wonder that until bankers achieve pricing discipline, commercial borrowers will continue to pick through the banks to their advantage.

Exhibit I

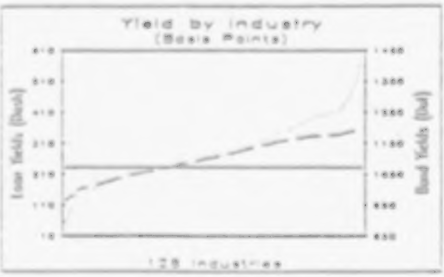
Loans and Bonds

The corporate bond market discriminates by industry. As the table below shows, the yield to maturity for the Air Transportation industry is +257 basis points (2.57%) over the average bond. In contrast, Drug bonds yield -74 basis points (.74%) below the average corporate bond.

Bankers are not nearly so discriminating. Relative to the average loan, Air Transportation loans are priced only 97 points above the average loan, while Drug company loans are only -31 points below average.

The chart shows 128 industries arranged so that the highest bond yield industries are on the right and the lowest are on the left. The broken line represents relative loan prices (left scale) while the dotted line shows bond yields.

Bankers and bond holders evidently agree on the industries in the middle. They part company, however, on the tails. If the bond market is more "efficient" in processing industry risk, this chart suggests that bankers overcharge their least risky customers (on the left) and seriously undercharge their most risky customers (on the right).



	Relative Bond Yield	Relative Loan Spread
Air Transportation	257	97
Machinery -- Wholesale	138	98
Auto Repair	15	9
Aircraft	(2)	(11)
Telephone Equipment	(133)	(54)
Drugs	(74)	(31)

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

PREPARED STATEMENT

of

JAMES C. MILLER III

DIRECTOR

OFFICE OF MANAGEMENT AND BUDGET

before the

COMMITTEE ON GOVERNMENTAL AFFAIRS

UNITED STATES SENATE

WASHINGTON, D.C.

MAY 14, 1986

Mr. Chairman and Members of the Committee: it is a pleasure to appear before you today to discuss S. 2230, the Federal Management Reorganization and Cost Control Act of 1986. As you know, I am deeply interested in improving the management of the Federal Government. I know you also share this goal, and the seriousness of your commitment is clearly expressed in this bill.

Let me begin my presentation by suggesting what I am persuaded is the best way to achieve our shared objectives. This involves two recommendations. First, I recommend that you delete those provisions of the bill that deal with the organization of the Executive Office of the President. I believe the organization of this office is uniquely a responsibility of the President. Second, I recommend that our respective staffs use the remainder of the bill as a basis for developing mutually acceptable legislation that will carry us forward toward meaningful reform.

Title I -- Improving Federal Management

Title I of S. 2230 would create a new Office of Federal Management, which would include the current Office of Federal Procurement Policy; the Office of Information and Regulatory Affairs; all management, organization, and legislative reference functions of the Office of Management and Budget (OMB); and a new Office of Financial Systems to oversee agency financial management. The remainder of OMB would be redesignated the Office of Federal Budget.

Both as a matter of effective management and deference to Constitutional prerogatives, I believe the President should have the broadest possible discretion in organizing his Executive Office. Moreover, with respect to continuing staff support functions in the management field, I believe the reorganization envisioned in S. 2230 is unnecessary, because an increased emphasis on management can be and is being achieved within the existing organizational framework.

Further, separating the management and budget functions would not increase the relative emphasis on management, but would set back our management initiatives by undoing the progress we have made in integrating and coordinating the efforts of the two staffs. I believe a close working relationship between the two functions is necessary for each to realize its full potential. For example, as you may know, many of our more important managerial initiatives are reflected in the budget. The proposed reorganization would make the kind of joint action we have been undertaking much more difficult.[1]

Of course, this is not to say that OMB's current management efforts are perfect or complete. We can and will make changes within our existing programs to strengthen the role of OMB in financial management, procurement oversight, and information resources supervision.

With respect to financial management, your proposal to create agency Controllers has merit as a concept. However, I fear that dual reporting by Controllers to their agency heads and to the proposed Office of Federal Management could lead to confusion and possibly inconsistent policies. A better outcome might well be achieved by establishing Assistant Secretaries for Management and Budget in the agencies. Because a number of relevant Assistant Secretaries are not responsible for their agencies' budgets, their ability to effect reforms is somewhat limited. Establishing Assistant Secretaries for Management and Budget would serve the interests not only of financial management oversight, but of good management generally and budgeting as well.

S. 2230 also proposes an Annual Management Report identical to the one required in S. 2004, the proposed Government Management Report Act. As I have indicated previously, I support the general concept: indeed, I had a major role in developing the President's Management Report issued on February 5th. However, I do not support the overly prescriptive nature of the requirements contained in S. 2004 and this bill. I understand that our staffs are working on an approach that should be mutually acceptable.

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[1] On this general theme, see my attached remarks, "Putting the 'M' in OMB," before the American Association for Budget and Program Analysts, National Press Club, Washington, D.C. (April 4, 1986).

Title II -- Accounting and Internal Control Systems

Title II of S. 2230 proposes to improve agency implementation of reliable and effective accounting and internal control systems and would require the President's Budget submission to include a description of the accounting systems that support the budget and problems with these systems. Further, when an agency failed within two years to comply with the accounting standards, the Administrator of the proposed Office of Financial Systems would be authorized to assume direction of that agency's accounting system.

While I agree with the need to move aggressively to secure agency compliance with Circular A-127 standards, I am not persuaded the proposed approach is the best way of securing this objective. First, I am reluctant to see any further expansion of the President's budget documents. Moreover, I doubt discussion of the accounting systems and their problems would contribute much to improving the budget process; indeed, in the budget context, the accounting issues might not get the attention they deserve. Further, the proposed report would duplicate reporting requirements of the Federal Managers Financial Integrity Act. It would seem a better approach is to include this information in the President's Management Report, as we have done in the past and would anticipate doing in the future.

Second, I doubt that turning supervision of an agency's accounting or internal control system over to a central agency would necessarily achieve agency compliance. A more constructive approach might be to direct an agency with a troubled system to work with and adopt the methods of a more successful agency. We are making progress in this area and would appear to be on the road to correcting remaining weaknesses in agency control and accounting systems.

Title III -- Agency Financial Statements

Title III of S. 2230 would require agencies to prepare annual statements covering their financial positions and the results of their operations. Financial and compliance audits would then be required, and the results would be reported to Congress.

We favor increasing the completeness, accuracy, and timeliness of our financial data. Better financial reporting by the agencies is a necessary first step toward improving discipline in financial management. However, some of the provisions of Title III are a cause for concern. For example, adopting General Accounting Office (GAO) standards would lead to far more thorough and comprehensive audits than could be accomplished with existing Federal audit resources. The costs of independent, external audits could be significant and appear not to have been taken fully into account by this proposal. We would propose to work with you on ways in which we at OMB can strengthen our oversight and increase Congressional confidence in agency financial information.

Title IV -- Cash Management

Title IV of S. 2230 deals with the flow of cash between the Federal Government on the one hand and its employees, taxpayers, contractors, grantees, borrowers, State and local governments, and others who receive funds from or who provide funds to the Federal Government on the other hand. We believe enactment of this title would go a long way toward modernizing the way the Federal Government makes its payments and collects its receipts. However, we note that there are some technical issues with the title that need to be resolved -- for example, in the section dealing with agency use of lockboxes.

We were pleased to see that this title is based, in part, upon the recommendations of the State/Federal Cash Management Task Force. That task force developed grant payment procedures that would be equitable to the Federal Government as well as to the States. We are in the process of developing an Administration bill that will be very similar to Title IV in this area. We have circulated a draft of the Administration bill and have received a number of comments from affected Federal agencies.

We also support the provisions of Title IV dealing with the use of electronic funds transfer to pay wages to Federal employees and speed up Social Security withholding.

Title V -- Credit Management

Title V of S. 2230 deals with managing Federal lending programs, and would put into law a number of initiatives that we are pursuing administratively.

As you know, we have made credit management one of our highest priorities. Appropriately so: the Federal Government is the largest financial intermediary in the United States, and directly or indirectly allocates a trillion dollars in credit. There is $257 billion in the direct loan portfolio; guarantees add $410 billion; and Government-sponsored enterprises have been advanced another $370 billion.

Most of the credit management provisions of this bill are already operative in OMB Circulars A-70 (Credit Policy) and A-129 (Managing Federal Credit Programs). While we do not think it is critical to embody such policies in legislation, we would have no objection to most of the provisions in this title. The goals of these proposals are consistent with the Administration's long-standing objectives of minimizing the disruption of private credit markets and ensuring that the true economic costs of Federal credit are measured and understood. However, we would want to work with your staff to improve the language of the bill.

On the other hand, we oppose the provisions of S. 2230 that would allow agencies to re-spend collections in excess of the established targets, or to reduce program funds by the amount an agency failed to meet its collection target. In certain cases -- for example, where revolving funds are used -- collections are available for purposes specifically authorized by law. However, in other cases it is a matter of basic law (31 U.S.C. 3202) and OMB policy that such monies be deposited in the general fund of the Treasury. This preserves the full range of options of the President and the Congress in allocating resources through the budget and appropriations process. This flexibility is essential to maintaining control over the size and scope of programs and determining priorities for use of limited budgetary resources.

We believe -- and the bill would seem to support this view -- that a sound credit program must lead to improved collections, a reduction in defaults on loans, and lower costs of administration. In addition, I believe a sound credit program will also lead to better decision making over the size of a public credit program by highlighting their true economic costs -- i.e., the subsidy portion. By doing so, a sound credit program will also reduce the overall subsidy.

We recognized early in 1981 that there were serious problems throughout the entire credit cycle -- from initial screening of applicants to ultimate collection. A Government-wide reporting system was established to provide data on aging of delinquent debt. The Debt Collection Act of 1982 gave agencies new authorities, and 1984 and 1985 were spent in implementing these new authorities. At this point, we have in place a comprehensive credit management framework that establishes standards for the screening, awarding, servicing, and collection of all loans and accounts receivable. The next phase will be to establish performance standards against which agencies will be measured, and to ensure agency implementation of the standards outlined in Circulars A-70 and A-129.

After some delay, we have made substantial progress. The 11 agencies that identified debt collection as a material, internal control weakness in their 1984 reports under the Financial Integrity Act were unable to implement the Debt Collection Act because of delays in issuance of the Federal Claims Collection Standards by GAO and the Department of Justice. When the standards were issued in March 1984, implementation began. Consider the following:

- Sixteen agencies have sent 2.3 million accounts to credit bureaus. The total amount at issue is $76 billion. These credit records make it difficult for an individual delinquent on a loan from one agency to secure additional credit from another. Since this also affects individuals' credit ratings, there is a strong incentive for them to repay the delinquent loans.

- Interest and penalty fines on delinquent debt are being charged by all agencies except where there is a statutory impediment or existing contractual agreement that precludes additional charges.

- Automated debt servicing is becoming more commonplace. The Department of Housing and Urban Development (HUD), the Small Business Administration (SBA), and the Internal Revenue Service (IRS) have automated collection systems now in place. The IRS computerized work stations have increased collections by $800 million each year and reduced staff requirements by 2,700 full-time-equivalents since 1982. Productivity for this activity increased by 397 percent. The HUD system services 65,000 accounts valued at $250 million and was credited with $576,000 in collections in 1985. The SBA system serviced 26,000 accounts in 1985 and helped boost total collections to about $1.4 billion.

- The General Services Administration has awarded contracts to four commercial collection agencies to provide services for all government agencies. About 32,000 accounts, valued at $160 million, have been placed so far, and we expect placements to increase significantly in the months ahead.

- Salary offset authority is being implemented by all agencies. About 135,000 Federal employees owing $275 million have been identified. Over $13 million has been collected.

- Five agencies have referred 750,000 accounts to the IRS for offset of income tax refunds. We estimate about $150 million will be recovered in the first year. Already, over $100 million has been collected. Plans are under way for the second year to include five to six more agencies and to double the number of referrals.

- As a last resort, written-off individual debt is being reported to IRS to be considered as income for the debtor.

- The President's FY 1987 budget proposes increases in user fees and interest rate levels for a number of credit programs. Additionally, we have made privatization an important goal in our proposals on Federal credit by recommending, among other initiatives, the sale to the public of a selection of loan assets.

- Through the Federal Credit Working Group, which is comprised of officials from OMB, Treasury, the Council of Economic Advisers (CEA), and various other agencies, we are addressing a broad variety of solutions to the problems of credit management.

Title VI -- Federal Information Policy

Title VI of S. 2230 would authorize appropriations for OMB's Office of Information and Regulatory Affairs (OIRA) for the period FY 1987 thru FY 1990; broaden the scope of OIRA and agency duties in the administration of information resources management; create an information technology fund; and make a number of other changes to the Paperwork Reduction Act.

In my judgement, many of the changes that would be made by Title VI require further work. Some of the proposed changes are unnecessary. Accordingly, we cannot support the title in its present form. However, I want to stress in the strongest possible terms my belief that legislation to authorize OIRA's appropriations is vital and must move very quickly. In each oversight hearing concerning OIRA, in each appropriation hearing concerning OMB, in my confirmation hearing, and in public and private discussions, we have made it clear that the Administration supports passage of legislation to further authorize OIRA appropriations.

If such authorization is to be moved rapidly, I believe it best to consider developing a separate bill -- one without the controversial provisions of Title VI, but with other provisions that are not now included. Therefore, Mr. Chairman, I ask you and other members of the Committee to introduce and report such a bill as soon as possible.

We have some ideas on such an initiative and would be glad to share them with you. In general terms, what I recommend is a stand-alone bill modeled on S. 2433, the Paperwork Reduction Act Amendments of 1984. As you know, this bill was cosponsored by Senators Danforth, Chiles, Durenberger, Levin, Cohen, and Pryor during the last Congress. As you also know, this committee held hearings at which OMB testified in support of the bill and the amendments that were adopted. S. 2433, as amended, was unanimously reported by this committee, with Administration support, on August 6, 1984. However, the bill did not reach the Senate floor before adjournment of the 98th Congress. I believe that a bill exactly like S. 2433, as reported, except to provide authorization for appropriations in different fiscal years, may well offer the best opportunity to enact the needed legislation.

Let me conclude, Mr. Chairman, by assuring you of my continuing interest in working with this committee. We are in basic agreement on the goal of improved management of the Federal Government. Our collective efforts are needed if we are to create the appropriate environment and provide the needed tools to get the job done.

Mr. Chairman and Members of the committee: that completes my statement. Now, I'll be happy to address any of questions you might have.

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

"PUTTING THE 'M' IN OMB"

by

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DIRECTOR

OFFICE OF MANAGEMENT AND BUDGET

before the

AMERICAN ASSOCIATION FOR BUDGET AND PROGRAM ANALYSTS

NATIONAL PRESS CLUB

WASHINGTON, D.C.

APRIL 4, 1986

In 1981, President Reagan promised "to limit Government to its proper role and make it the servant, not the master, of the people." And in his first inaugural address he said: "It is not my intention to do away with Government; it is rather to make it work." The efforts I shall describe today are designed to make good on those two promises.

The sentiment the President expressed -- questioning the proper role of government -- was and is visionary, because it places in question the value of an ever-expanding Federal government -- the assumption that more is better. In a sense, the President has called for a re-evaluation of the premises underlying the growth of government. What we in the Administration have found is that "more", in the case of Government, generally has become "less" -- less effective, less efficient, and less responsive to needs, with one exception -- more expensive.

When the President questioned the role of the Federal Government, in a way he was reflecting what every effective new CEO of a company has to ask: what is my company here for?; what is our mission?; what are our goals?; what are our short-term/long-term business plans?; what are our implementing strategies?; where is waste that is reducing our bottom line?; how are we managed?; and what information do we use and is it accurate? These are all management questions. They can also be viewed, in one sense, as budget questions, because they lead inexorably to our Federal bottom line.

It's my belief that the creation of a budget is part of a management process. For too long, creation of the budget has been a narrowly-defined end in itself. No more. The budget process should be an exercise that forces the right questions to be asked and answered. It should be one of several important management plans that are prepared each year. The creation of this year's budget was in a sense a management exercise, because management decision-making processes were used by OMB to formulate its details. Also, management actions are needed, ultimately, to implement the individual initiatives the budget incorporates.

To illustrate the point, let me share with you some of the thought processes we followed in working with the agencies to put together the details of the President's budget.

But let's start with a little history. Ever since OMB was first formed in 1970, the marriage between budget and management (including procurement and regulation) has been less than perfect. Sometimes it seemed more like a trial separation. Objectively speaking -- easier for someone who has been at OMB less than six months -- the budget and management sides remained in opposite camps.

The organizational merging that should have taken place and which would have strengthened the entire agency just didn't happen. Part of my job, as I see it, is to follow the President's lead and establish a high priority on management reform and to encourage all to view budget and management as a single process. To view the role of OMB as overseeing the delivery of better government -- not just less government. To put the "M" firmly into OMB.

I should note, however, that the movement to merge management and budget roles has received considerable impetus by this Administration -- starting with the President's role, reflecting his efforts to secure better management as Governor of California. Ed Meese, during his years at the White House, and more recently Don Regan, as Chief of Staff, have lent a great deal of support to the overall effort. This focus on management improvements -- a stark contrast to previous Administrations' preoccupation with program expansions -- has also received widespread support from academic, as well as political, circles. Scholars such as Richard Nathan, Chester Newland, and Stephen Hess have discoursed on both the need for and acceptance of the "administrative Presidency". This President is generally acknowledged to have done more to change our thinking about the administration of government than anyone in recent history.

President Reagan has brought a business-like approach to the administration of the Executive branch. He knows that leadership implies good management, as well as good policies. And that it is good management that gets us to our "bottom line" -- effective government within a balanced budget.

As many of you know, some merging of the management and budget sides -- a logical outgrowth of the "administrative Presidency" -- was already in motion prior to my arrival at OMB. First, the management review process for the FY 1987 budget -- undoubtedly the most effective combined agency effort to date -- was actually initiated in the late summer of 1985, prior to my nomination. OMB's Deputy Director, Joe Wright, did an able job of providing leadership during this exercise. Second, the results of the management reviews were fed into the budget so that when costs were reduced, the savings could be captured and used to reduce the deficit. I understand this was not done before!

So, the stage was set, although we still had to identify a conceptual framework which would redefine and expand management (in the larger sense) and budget into longer-term planning and day-to-day decision making. In my view, we at OMB have been defining management too narrowly -- and so we expanded it during this recent budget process.

Since a substantial part of what is called good management is based upon first determining your decision process, the key tool this year in our efforts to improve the administration of the Federal government -- to reduce costs and to move towards a balanced budget -- was our use of themes or management "decision rules." In putting together a budget that would provide the requisite $38 billion in deficit reduction, we recognized that tough decisions would have to be made and that a logical framework would be invaluable in helping us be consistent in those decisions and in providing a cohesion of purpose across agency lines. We did that -- and it was not unlike a CEO that asks the questions I mentioned earlier about the company's product lines and managment processes.

Our management "decision rule" went something like the following. We began by asking ourselves:

> "Is this a function that the Federal government should be performing?"
>
> "If not, by whom should it be accomplished?"
>
> - "By another level of government through devolution or Federalism?"

- "By the private sector through asset sales, privatization, or contracting out?"
- "Or should it be performed at all?"

"If, on the other hand, we determined that a function should be accomplished by the Federal government:"

- "Is it presently being performed at the right level, or should it be expanded, contracted, or frozen?"
- "Also, would it be accomplished more cost-effectively as a result of reducing waste, fraud, and abuse; productivity improvements; efficiency enhancements; or other changes in program delivery?"

Well, these are the concepts we at OMB followed in working with the agencies to craft the details of the President's budget -- in keeping our eye focused on narrowing the current scope of Government activities but improving their impact. Adherence to this philosophy -- not only at OMB but at the agencies -- plus a little cooperation from Congress(!) should enable us to provide only those services deemed necessary and essential, toward which all taxpayers should be contributing -- and providing them as efficiently as possible. So how did the decision rule work in practice?

One corollary of our management "decision rule" is that high-priority programs should receive adequate funding. Despite the extremely tight fiscal environment in which we are operating, the President's budget provides funds for maintaining -- in some cases even expanding -- high-priority programs that have been judged crucial areas of national interest. Necessary services and income support for the dependent poor and for the elderly receive significant funding in this budget. So do other programs of demonstrable national interest, such as drug enforcement, AIDS research, the temporarily besieged space program, non-military research, and of course, our national security. But then the question remained: are these high-priority efforts well managed to be most effective? Are the scarce dollars getting results, or are unnecessary Federal bureaucracies just draining funds?

For those programs determined not to be in this high-priority category, a second corollary of our management decision rule is whether the service might be better accomplished by State and local governments. Over the past 50 years, the Federal government has pre-empted many functions that more properly belong at the State or local levels. In an effort to restore a more balanced, constitutionally appropriate Federal structure, the President's budget continues the President's goal of ending intrusion into the State and local spheres by attempting a clear delineation of roles for the various levels of government. Building on the success of block grants for social services, health, education, job training, and community development -- block grants for which funding will be continued -- this budget proposes new consolidations of restrictive small categorical grant programs into block grants for transportation and pollution control. While the cost to the Federal governments is reduced, the benefits to state and local governments are increased.

Other programs are also being proposed for devolution to the State or local levels, such as administration of the Agricultural Extension Service. Also, the budget proposes that the Federal government get out of providing for local sewage treatement systems, local airports, local law enforcement, subsidies to State maritime schools, and local coastal management -- all responsibilities more appropriately assumed at the State or local levels.

A third corollary of our management decision rule is that the Federal government should not compete with the private sector. Traditionally, governments were established to supply services that were needed by the public, but that were not provided sufficiently by the private marketplace. Over the years, however, the Federal government -- either by default or design -- has gone far beyond this traditional role and has acquired many commercial-type operations. In our budget deliberations, we found many instances where the Federal government should stop competing with private industry and transfer to the private sector those activities, assets, and services that belong there.

In many cases, the Federal government provides commercial services at very high costs, uses its borrowing lines to compete unfairly with effective private-sector services, or sits on unused assets that could benefit the economy if they were put into productive use. Examples of privatization initiatives in this budget include the sale of the power marketing administrations and the naval petroleum reserves, and implementation of housing and education voucher programs. Give the private sector a break for a change!

The budget also proposes the sale of unneeded assets such as loan portfolios and surplus real estate, and increased contracting out of appropriate Federal services through the Circular A-76 program. This last effort has been a real failure in almost all agencies except Defense: for some reason, most agencies appear to want to hold onto their Federal workforces -- despite the costs!; and on occasion Congress has erected roadblocks which exacerbate the problem! That must change.

A fourth corollary of our management decision rule is that programs which are counterproductive, unnecessary, or simply no longer affordable by government should be ended. Since it would not be appropriate or feasible for either the private sector or for State or local governments to assume such functions, the budget proposes that they be terminated immediately, phased out in an orderly manner, or eliminated when their legal authority expires. Some 90 programs fit this category, including the Economic Development Administration, the Interstate Commerce Commission, Maritime Administration loan guarantees, education subsidies for health professionals, the work incentive program (WIN), and subsidies for air carriers.

For the remaining programs, some needed to be reduced to a more appropriate level to meet "real needs". But for all such remaining programs we had yet another concern: can we manage them better? As we proceed with the deficit reduction process and meeting the President's goal of a 20 percent improvement in productivity in selected areas, it is important that all operations be well managed and coordinated to avoid duplication, to reduce waste and other unnecessary costs, and to minimize regulatory burdens imposed on the private sector. Management efficiencies that are the focus of Reform '88 must accompany the process of developing a leaner, more carefully focused Federal role. We can no longer afford unnecessary overhead and other inefficiencies when we are scaling back both the role and the cost of the Federal government!

And finally, one last means of reducing costs to the taxpayer is charging or increasing user fees to those who receive special benefits and services. Recipients of such Federal favors should be the ones to bear their costs, not the general taxpayer. Accordingly, the President's budget imposes fees and premiums for Federal guarantees of loans. In addition, it imposes user fees and assesses charges in order to recover Federal costs for meat and poultry inspection, National park and forest facility use, harbor and inland waterway use, Coast Guard and Customs inspections, and many other services. We consider that good management. Those who buy should pay the price. And just as importantly, those who don't buy shouldn't have to pay the price.

There you have it: the major steps we went through in developing the details of the FY 1987 budget. As you can see, the creation of the budget was a Management exercise with a capital "M". And we expect to improve on this process next year. But we need better information from, and cooperation with, and determination by, the agencies. In short, we will be looking at the agencies to pick up the "expanded Reform '88" effort and make President Reagan's efforts to improve management of the Federal government an enduring legacy.

Thank you very much!

RESPONSES OF MR. MILLER TO WRITTEN QUESTIONS

Question 1: You said in your April 4 speech that "the marriage between budget and management ... has been less than perfect. Sometimes it seemed more like a trial separation. Objectively speaking ... the budget and management sides remained in opposite camps." You also say things will be different. How are you mitigating the historic animosity between the budget and management camps so as to permit you to carry out those good intentions?

Answer: I have taken a number of steps to build a solid basis for continued emphasis on management improvement. Most importantly, the management review process has become an integral part of the budget process so that, even if the management initiatives change, the level of attention to management issues can be maintained. Both staffs have become more cognizant of the relationship and interdependency of the two functions. Our process of reviewing and approving agency proposals for information technology investments is an example of how the various OMB offices cooperate. OIRA, management, and budget staff activities in conducting this critical process are completely integrated.

The very real accomplishments of Reform '88 and our other management initiatives clearly demonstrate that needed management improvements can be made. Through Reform '88 we have established the Productivity Improvement Program; reduced fraud, waste, and abuse; eliminated unnecessary publications; revised travel procedures to reduce costs; consolidated administrative service units; begun to develop generic administrative systems to be used across Government; tightened cash and debt management practices; and begun to reduce the number of accounting systems.

Question 2: Suppose we decide to go ahead with title I of S. 2230, notwithstanding your position. Given the track record of OMB in the management area since 1970, do you have any constructive alternatives to offer on the management office established by the bill?

Answer: First, as I indicated in my prepared statement, I believe any reorganization that separated OMB's management and budget functions would be a mistake. At the same time, I believe that some restructuring within OMB might be appropriate, and I look forward to working with you as I consider this question further.

On a broader level, what is needed is a more supportive relationship between the Administration and Congress. A number of initiatives are currently frustrated by congressional inaction or opposition. For example, our A-76 program is seriously limited by statutory impediments in spite of studies by GAO and the Grace Commission that demonstrate that this approach is an effective management tool and in spite of our clear commitment to protecting the interests of employees. There have been situations where Congress has acted to stop consolidaton of field offices that were established decades ago, when the nation's transportation and communications systems were, by today's standards, primitive. And we can get little visible support from Congress for an undertaking so obviously worthwhile as the Productivity Improvement Program.

Question 3: You note in your April 4 speech that "management efficiencies" are the focus of Reform '88. We agree this is important, but we are also concerned about building the capacity of agencies to manage their programs effectively--or to paraphrase President Reagan--to make Government work.

a. What capability does OMB have to troubleshoot emerging problems, such as those we've seen recently at NASA and IRS, before they become acute and highly visible?

b. What assistance is OMB prepared to give to these agencies to set their houses in order?

Answer: I share your concern about building the capability of agencies to manage their programs effectively. The management improvement activities of this Administration have been directed to this objective.

The most effective way for OMB to assist troubled agencies is by identifying agencies where comparable problems have been solved and facilitating interagency sharing of expertise or technology transfer. Our policy has been, and should continue to be, to use our limited resources to oversee and influence management improvement through analysis of broad issues, some Government-wide and some agency specific, in which we encourage the agencies to build on existing, detailed problem analyses by GAO, the Inspectors General, and the agencies themselves.

With respect to identifying emerging problems, I would point out that this is an area where coordination between OMB budget staff -- who have daily contact with the agencies they oversee -- and management staff -- who have the expertise to analyze possible problems -- is especially important. Separating the budget and management staffs would reduce our effectiveness in this area.

Question 4: You have stated that, "the entire staff of OMB is devoted to management functions." What specific actions have you taken to get budget examiners more involved in management functions, other than through exercise of your "management decision rules"?

Answer: As I said in response to an earlier question, we have fully integrated the management reviews into the budget cycle. The budget, OIRA, OFPP, and Legislative Reference staff are much more cognizant of management issues than in the past.

Question 5: The staff allocated to management and information and regulatory affairs has declined from 138 in 1981 to 109 in 1986, a 22-percent drop. Even fewer staff are requested for FY 1987. How can you carry out the basic tasks we all agree need to be done at these staffing levels?

Answer: As I have said, virtually all OMB staff perform management functions. While OMB has been shrinking, in real terms, for several years, the staffing level proposed for OMB in the President's FY 1987 Budget provides for sufficient staff to carry out our management initiatives and perform the basic tasks we need to do. As indicated in our FY 1987 budget justification materials, our FY 1987 budget request reflects a slight increase in the proportion of OMB's funding and staffing resources devoted specifically to the management area.

Question 6: On page 2 of your written statement, you said you can and will make changes in your existing programs to strengthen OMB's role in financial management, procurement oversight, and information resources supervision. What changes do you have in mind?

Answer: At the beginning of this Administration, OMB's financial management responsibilities were carried out by a branch in our Budget Review Division. Reorganized in 1982, these responsibilities are now carried out by a separate Financial Management Division. Permanent staff of the division is assisted by a series of interagency task forces set up to implement new statutory responsibilities under the Federal Managers Financial Integrity Act, the Debt Collection Act, the Prompt Payment Act, the Single Audit Act, and parts of the Deficit Reduction Act. In other words, the expertise that exists throughout the Government is utilized; it need not be duplicated at OMB.

These efforts represent a substantial increase in commitment and accomplishment in financial management.

OMB's strategy for strengthening information resources management has five components: (1) issuing policies where they are deemed to be needed; (2) encouraging improved planning by agencies; (3) selectively reviewing agency information management activities;

(4) amending GSA's FIRM regulations with regard to Brooks Act Procedures; and (5) seeking legislative changes modeled on S. 2433 from the 98th Congress.

Several recent and upcoming initiatives demonstrate our commitment to better Federal information resources management. In December of 1985, I signed OMB Circular A-130: the first comprehensive statement of Federal information resources management policy in more than 20 years. OMB will shortly issue the fourth Government-wide, five year plan for automatic data processing and telecommunications. This year--for the first time--we will be publishing descriptions of significant information technology initiatives in each agency.

Further, we have recently initiated senior level reviews of the most critical and largest Federal information systems projects. To date, reviews have been conducted of the Internal Revenue Service Tax System Redesign and the Patent and Trademark Office Automation Project. Others scheduled for review in the next few months include, the Social Security Modernization Program, the Federal Aviation Administration System, and the plans for the 1990 Census.

With regard to strengthening OMB's role in procurement oversight, we hope to select a new Administrator for the Office of Federal Procurement Policy very shortly. We also expect to fill several of the key professional vacancies in the Office in the near future. We are also involving OFPP fully in the management review process and are including more procurement issues in the reviews.

Question 7: You object to the "dotted line" relationship between the agency controllers and the Office of Financial Systems in title I. Yet you advocate establishing Assistant Secretaries--OMB counterparts--for Management and Budget. Wouldn't we inevitably end up with the same type of dotted line relationship, but on management issues across the board?

Answer: As I said in my prepared remarks, I am concerned about the proposed dual reporting by agency controllers to the proposed Office of Financial Systems and to their agency heads. While the informal relationships between agency components and their OMB counterparts are important and productive, the formal, statutory chain of command must be between agency components and the agency heads. I do not propose that Assistant Secretaries for Management and Budget be required in law to report to their OMB counterparts, nor do I favor such a statutory "dotted line relationship."

As you know, a number of agencies have separated management oversight from budget development. We have seen the most effective management improvement programs in those departments where the Assistant Secretaries for Management also have budget authority. A combination of management, budget, and comptrollership would probably be best of all from the perspective of management improvement. One of the reasons we oppose the proposed separation of management from budget in the Executive Office of the President is that we have seen the problems created for management in agencies where a comparable separation exists.

Question 8: You have stated that OMB is addressing "human resources management" through the President's productivity improvement program. We applaud this effort, but are there not other aspects which OMB should be addressing, such as ensuring we have qualified, capable managers in executive agencies?

a. What is OMB doing on issues such as executive selection, recruitment and development, and executive salaries?

b. The National Academy of Public Administration recently issued a report on Presidential appointees, covering financial disclosure and conflict of interest, transition and orientation of new appointees, and needed improvements in the appointees' working environment. What measures have OMB and the Administration taken to lead the way for these reforms?

Answer: OPM and OMB work together to foster management excellence. Because of the intimate relationship of these activities to the OPM mission, direct action on executive selection, recruitment, development, and salaries is, and should continue to be, the responsibility of the Office of Personnel Management. The OMB role is to set goals that create an environment where capable managers will exercise their skills fully.

During this Administration, the agencies have provided leadership in meeting the needs of political appointees for guidance in financial disclosure and conflict of interest. Still, I agree that more could be done in this area, and I will work with OPM to develop and implement any needed reforms.

Question 9: Numerous witnesses have cited the need for fundamental financial management reforms and a stronger institutional focus on this issue. What actions are you taking to respond to these widespread concerns and what assurances can you provide that the actions you are taking will result in the sustained, long-term improvements needed?

Answer: The full resources of OMB are committed to reform of Federal management, particularly financial management. Many of our Reform' 88 initiatives are financial in character: cash management, credit management, debt collection, internal control, accounting systems, audit reform, grant administration, etc. The results of these efforts are summarized in the President's management report to the Congress, and represent an unprecedented record of accomplishment. All of these reforms have been incorporated into permanent OMB policy directives and will be sustained over the long term.

As I said in response to an earlier question, we have substantially increased the organizational emphasis placed on financial management issues by upgrading this activity to a separate Financial Management Division and by seeking assistance from a series of interagency task forces to implement new statutory responsibilities.

Question 10: Title II of S. 2230 raises the notion of a receivership function for those agencies whose accounting and internal control systems do not conform to required standards by a certain date as determined by the Administrator of Financial Systems. You express doubts about this solution and offer as an alternative directing the agency with a troubled system to work with and adopt the methods of a more successful agency.

a. Why do you believe this approach will work?

b. How is OMB going to direct such action? What will OMB do if the agency still does not act to upgrade its financial systems?

Answer: We believe this approach would leave operating responsibilities where they belong; i.e., with operating agencies. A good deal of this type of cross-servicing is done currently for reasons of economies of scale. We would envision a troubled agency working out arrangements for assistance with an agency that was up to standard under the guidance of OMB.

OMB would make these cross-servicing arrangements as we have in the past by working through our Financial Management Division and the appropriate examining (i.e., budget) divisions. Agencies that could not bring their systems up to standard would simply have to rely on other agencies for financial services and would not receive funds or staffing for maintaining substantial systems.

Question 11: With respect to the requirement in S. 2230 to disclose the condition of accounting systems in the budget, this need not be an onerous reporting burden but merely full disclosure to the Congress as to a relevant factor that could impact on the budget numbers. Would you object to a requirement that this summary information be provided in agency budget justifications, rather than the President's budget?

Answer: No, but we believe such a requirement would duplicate reports already required by the Federal Managers Financial Integrity Act. As you know, we summarized those reports in the President's Management Report to Congress last year, and we plan to continue doing so.

Question 12: You mentioned on page 3 of your statement the need to move aggressively to secure agency compliance with OMB Circular A-127 standards for accounting systems. S. 2230 refers to the Comptroller General's principles, standards and requirements for accounting and internal control systems. Does A-127 require compliance with the Comptroller General's standards?

Answer: Yes, standards developed by the Comptroller General are implemented through Circular A-127 "Financial Management Systems." Guidance on implementation of standards takes into account the need to consolidate and streamline systems, use of the best acceptably priced technology, consistency with budgetary systems, the needs of management, and the costs and benefits of application in particular circumstances.

As I mentioned earlier, I am concerned about the constitutional issue of reporting relationships between executive agencies and GAO. This bill, by requiring compliance with GAO standards, raises similar questions.

Question 13: For over 50 years, publicly-held American corporations have been required to prepare financial statements which can sustain the scrutiny of an independent audit. The Congress required New York City to do the same as a condition for assistance during its financial crisis, and the Single Audit Act passed under the leadership of this committee requires this of state and local Governments receiving federal assistance. State and private sector officials testified as to the importance and value to their organizations of audited financial statements. Is it not time the federal government followed suit so the Congress and the public receive a full and accurate accounting based on common accounting standards and audited by an independent party?

Answer: I agree fully that audited financial information brings greater discipline to the recording and presentation of that information. We have urged agency Inspectors General to make audits of such information, particularly information reported by agencies on debt collection, payment systems, and internal controls. We will continue these efforts with individual IG's and through the President's Council on Integrity and Efficiency.

Once again, I am concerned about the requirement to adopt General Accounting Office standards. In addition, the requirement in S. 2230 could lead to far more thorough and comprehensive audits than could be accomplished with existing Federal audit resources. The costs of independent, external audits could be significant and appear not to have been taken fully into account by the proposal.

Question 14: You mention that better financial reporting by the agency is your alternative to financial statements. Please describe what you mean by "better financial reporting" and explain how this differs from the reporting requirements in S. 2230.

Answer: —Agencies presently are providing all the information needed for financial reports to the Congress, Treasury, and OMB. By better financial reporting, we mean improvements in the quality of the agencies' reports. We are seeking to improve timeliness, comparability, and accuracy through use of modern technology and uniform definitions and classifications. If it is this type of improvement that is contemplated by S. 2230, then there would be no difference.

Question 15: We are aware that debt collection has been one of your management priorities and applaud your efforts to tackle this important problem. However, we heard testimony about the serious remaining problems in debt collection. Despite the improvements you cite, delinquent debts almost doubled since 1982.

a. When can the Congress expect to see the results of the debt collection improvements you cite in terms of actual dollars that we can use to meet budget targets?

b. If we agree with your problem on incentives in Title V, what other incentives in this area would you suggest to motivate agencies to collect more effectively debts owed the Government?

Answer: As reported by the President in this year's management report, we now have in place a comprehensive credit management program that establishes standards for the screening, awarding, servicing, and collection of all loans and accounts receivable.

Loan delinquencies, excluding foreign debt and foreign military sales, increased from $8.9 billion in 1982 to $12.7 billion in 1985, an increase of 43 percent. The primary source of the increase was the depressed agricultural economy. Agriculture loan debt increased 141 percent (from $1.9 billion to $4.5 billion) for the same period. If we exclude agricultural loans, delinquent loans increased by 17 percent. While the delinquent amounts have increased since 1982, the rate of growth in delinquencies has decreased.

We have already seen substantial results from our credit management and debt collection program. Agency budget estimates take these reforms into account and have for the past several years.

In addition, the Deficit Reduction Act of 1984 included a specific estimate for increased collections expected to result from IRS offset of income tax refunds against delinquent debt. Thus far, in the first year of the offset program, over $165 million has been collected.

We believe the Federal personnel system provides incentives for individual employees and managers to collect debts and run credit programs more efficiently. These incentives include promotions, step increases, merit pay increases, bonuses, etc. By making credit management one of the Administration's top priorities, we expect these incentives to be applied to credit management and debt collection. In fact, we specifically called for this in OMB Circular A-129 "Managing Federal Credit Programs".

Question 16: Is there any unit in OMB responsible for giving systematic attention to Government organization issues? What expertise do you have on hand to restructure Government after all the changes we've made in the past five years?

Answer: Most organizational issues are dealt with jointly by the specific agency budget examiners and the management staff with expertise in this area. This was the approach we took in working with agencies to consolidate their administrative support functions, including personnel, procurement, financial management, property management, records management, mail, printing, duplication, and motor pools. Considerable progress has been made by agencies which are centralizing and automating these functions, using staffing guidelines and performance standards to reduce administrative costs.

While we do not lack expertise to restructure Government, we do lack necessary flexibility and authority in many situations. For example, organizational changes to improve efficiency are blocked by statutory floors in agencies. Further, we lack authority to submit major reorganization proposals to Congress for expeditious decision; our proposal to renew this authority (which expired in 1984) through 1988, has not been enacted.

Question 17: We've seen some novel organizational ideas come along in recent months. One example is the Federal Asset Disposal Association recently established by the Federal Home Loan Bank Board to carry out a Board--and therefore a Governmental--function without any direct tie or accountability to the Board. The head of this association is to receive a $250,000 salary--more than the President. In your view, should OMB evaluate organizational changes such as this? And, if so, what resources does OMB have to do so on a sustained basis?

Answer: While OMB has a role in evaluating agencies' major organizational changes, the example you have chosen falls outside our jurisdiction. The Federal Home Loan Bank Board chartered the Federal Asset Disposal Association under authority vested in section 406 of the National Housing Act. OMB has no authority to interfere with this arrangement or any other association chartered by the FHLBB.

In general, organizational issues are dealt with jointly by the appropriate budget staff and the management staff with expertise in this area.

Question 18: The Packard Commission has made numerous proposals to reform defense management and procurement across Government. The President has endorsed these proposals.

a. What is OMB's role--particularly the Office of Federal Procurement Policy--in implementing these proposals?

b. The Commission proposed recodification of Federal laws governing procurement into a single, greatly simplified statute, but Congress resisted earlier efforts along these lines. Are you prepared to give this another try? If so, do you have the staff in OFPP to do this job?

c. The Commission found that lasting progress in the performance of the acquisition system required dramatic improvement in the management of acquisition personnel at all levels of Government. Is OMB doing anything new to address this problem?

Answer: OMB's role in implementing the Packard Commission recommendations includes evaluating the DOD implementation plans that include acquisition matters. This will be done jointly by the Office of Federal Procurement Policy and our National Security Division.

OFPP is developing, with the assistance of the major procurement agencies, a legislative proposal for a single greatly simplified procurement statute, which was recommended by the Commission. The recommended recodification is being undertaken by a task group that includes representatives of DOD, GSA, DOE and NASA, under OFPP's sponsorship. We believe that, with the cooperation of the supporting agencies, we have sufficient staff to get the job done. The success of our efforts will depend upon the cooperation of the Congress.

A very positive and, we believe, effective step has been taken to strengthen our procurement workforce. The Federal Acquisition Institute (FAI) in GSA (acting as executive agent of OFPP/OMB) has developed, in conjunction with OPM, a competitive exam that will allow the agencies of the Federal Government to compete effectively with industry for top college graduates entering the procurement workforce. Nearly 30,000 people have already signed up for this exam. OPM's testing of the exam's validity is proving it to be very positive.

We are also, through the FAI, developing the body of knowledge necessary to permit procurement personnel to succeed in a procurement career, and we are using that information to develop a Government-wide model curriculum and certification program that will initially be implemented in GSA. FAI is assisting agencies to establish career management programs as required by President Reagan's E.O. 12352.

The FAI is also surveying all procurement training now available in the executive branch and advising agencies on the need to eliminate duplication, share facilities, and upgrade materials. It will soon publish, moreover, a Directory of Academic Institutions that provide procurement education.

Question 19: On the information management title, do you have any specific suggestions for perfecting the language now in the bill, or, alternatively, S. 2433, as reported by the Committee in the 98th Congress?

Answer: As I said in my prepared statement, I believe that a bill exactly like S. 2433, as reported, except to provide authorization for appropriations in different fiscal years, would provide the best opportunity to enact the needed legislation. We have provided to the Committee a draft amendment to substitute this language for existing Title VI. The substance is identical to that in S. 2433, as reported, except that the authorization language is identical to that in Section 610 of S. 2230. We also corrected a few typographical errors, e.g., to make the Levin-Rudman Amendment identical to the provision printed in the 1984 Committee Report (by changing an "of" into a "to" in new section 3518(g)(1)(c)). We also adapted the amendment to the style of S. 2230 by including a new statement of "purpose and summary" based on the statement in the 1984 Report; ordering the sections in sequential order, based on the section of the Paperwork Reduction Act of 1980 that is being amended; and adding headnotes to each section. We are working with various members of the Committee on some other changes and will promptly advise you of any future recommendations for change.

Question 20: The Committee is also considering S. 2142, which would provide for marketing of new Federal loans, starting in October 1986, and showing the true cost of loan subsidies in the Federal budget. Other loan marketing proposals were discussed at the hearing.

a. How would such a plan fit with Administration initiatives for marketing existing loans and getting out of the direct loan business?

b. What are your views on the techical approach taken in S. 2142?

Answer: We are still studying S. 2142 and other legislative proposals dealing with the sale of and accounting for loans. After additional consultation within the Administration we will be in a better position to evaluate these proposals.

A Strategy for Improving Federal Credit Program Management

A Report Prepared by

The Research Center for
Government Financial Management
(Affiliate of the Private Sector Council)

PSC

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PART I--EXECUTIVE SUMMARY

In the past decade, Federal credit activity has expanded rapidly. In 1983, Federal net lending was $86.5 billion compared to $25.5 billion in 1974. The net lending was estimated to be $88.5 billion in 1984 and $94.8 billion in 1985. The total outstanding Federal credit at the end of 1984 was estimated to be $936.4 billion and at the end of 1985 to be $1,031.4 billion.

With the mounting Federal deficit, both the Congress and the Administration are concerned with improving Federal financial operations and reducing the deficit. At the request of the staff of the Senate Budget Committee, the Private Sector Council's Research Center undertook a study of the Federal credit programs. The purpose of the study was to review and make specific recommendations for improving the credit programs and policies. Some 450 statutes and regulations dealing with loan and loan guarantee programs administered by 13 Federal agencies were reviewed.

Our overall conclusion was that, in general, Federal loan program managers are concerned with or concentrate on getting funds into the hands of borrowers quickly and easily to fulfill what they see as their prime responsibility. Because of political and administrative pressure, there appears to be less inclination (1) to ensure that loans are appropriate and risk worthy, and (2) to monitor and collect the outstanding loans properly and in a timely manner. The emphasis is on "marketing," i.e., accepting applications, approving loans and disbursing funds. "Management" of outstanding loans, in the form of servicing and collection, receives much less attention. Overall, Federal loan program managers should adopt an attitude that an appropriate balance in "marketing" and "management" emphasis is necessary to good credit management.

Credit management consists of several distinct functions: application review, approval, disbursement, servicing and collection. None of these functions should operate in isolation. The basic concept needs to be inculcated that the credit process is an entire integrated system and not a series of unrelated functions. If any weakness exists in an activity within the process, the total system becomes less efficient. Highly efficient loan origination, for example, is of limited value if little or no attention is paid to servicing and collection.

Although we acknowledge that much improvement has taken place in credit management through the efforts of the Congress, the Office of Management and Budget, and operating agencies over the past few years, we believe that the Federal credit management process could be further improved by giving proper emphasis and attention to both marketing and management areas. In this context, we offer in this report a series of practical recommendations to further increase efficiency and effectiveness in Federal credit management by adopting certain private sector practices and procedures. Some recommendations apply across the board to all loan programs and, therefore, an overall approach (such as an omnibus bill or central executive policy promulgation) is appropriate. Other recommendations are applicable to a specific program or a group of specific programs. These are summarized below.

An overall approach should be taken for the folowing recommendations:

a. A uniform and integrated Federal credit management information system should be established to facilitate better loan making and loan management.

b. Risk analysis standards should be developed to enable consistent risk rating of individual loans and risk analysis of loan porfolios.

c. A government-wide policy should be established to allow government credit only when borrowers cannot obtain reasonable credit from private sources.

d. A standard policy should be established for charging origination fees, loan fees and guarantee fees for all Federal credit programs.

e. A uniform, government-wide policy should be established to allow interest rates to fluctuate consistent with some widely traded financial instruments. This policy would be compatible with program intent but would replace legislation that fixes interest rates or allows agencies to set interest rates at their discretion.

f. Private lenders should be required to bear at least 20 percent of the risk on Federally guaranteed loans. Also, the concept of "certified lender program" should be authorized in all Federal loan guarantee programs.

g. Legislation should be passed requiring that (1) all new bills creating credit programs contain a sunset provision, and (2) all existing credit programs be subject to sunset review in five years.

h. The unified budget should include all Federal credit activities that are now classified as off-budget outlays, especially those of the Federal Financial Banks to provide better visibility and management of Federal credit programs.

i. Standard definitions and criteria should be provided for terms such as debt, delinquency, default and write-off to achieve more consistency and better management of credit programs.

j. A standard should be developed for reporting delinquencies and defaults to agency heads or other top management officials within a specified number of days after they occur so that timely debt collection action can take place.

k. Legislation should be passed requiring that (1) all new bills creating credit programs specify the beginning date for repayment on government loans and the length of the repayment period consistent with program intent, and (2) all existing authorizing legislation without such provision be amended within reasonable and practical time periods.

l. In order to accelerate cash collection and reduce government borrowing, lending programs should require repayments through the Treasury Financial Communication System or the use of lockboxes whenever they are feasible and advantageous.

m. The Debt Collection Act of 1982 should be amended to state specific conditions and criteria for exempting, loan programs from charging interest, penalties and administrative costs for delinquent loans and to require charging of interest, penalties and administrative costs whenever loan programs do not meet the exempt conditions and criteria.

n. Standard provisions should be established for loan forgiveness which are specific and uniform for application in all Federal loan programs. The provisions would include: (1) appropriate use of revised repayment schedules and partial loan forgiveness as an alternative to forgiving the entire loan, and (2) a requirement for timely write-offs of loans forgiven.

o. Legislation should be passed requiring that (1) all new bills creating credit programs require performance standards that set goals and provide incentives for better debt collection, and (2) such performance standards be established administratively for all existing credit programs.

In addition to the overall approach as described in the preceding paragraphs, the following actions should be taken for specific programs or a group of specific programs:

a. For direct loan programs of the Small Business Administration, the Farmer's Home Administration, and the Rural Electrification Administration, a consistent policy should be established that would allow more flexibility in providing loans or loan guarantees, as appropriate. Further, these direct loan programs should be gradually phased out in favor of guaranteed loan programs.

b. A general review should be conducted of credit programs by agency program managers to prevent premature loan disbursements in advance of actual needs and to avoid payments of interest subsidies on guaranteed loans that have not yet been actually disbursed by the lending institutions.

A more detailed description of the scope and methodology of this review is provided in Part II--Introduction of this report. Part III provides the Background for Federal Credit Program Improvement Efforts. Narratives, including discussions of the issues and basis for our conclusions and recommendations, are provided in Part IV--Discussions of Specific Issues. That section is followed by a matrix of statutory and regulatory requirements that serve as impediments to or support for the "issues" raised in the review.

PART II--INTRODUCTION

Purpose

Both the Congress and the Administration are concerned with improving Federal financial operations and reducing the current deficit. This is a key priority of the Senate Budget Committee, and knowing of the Private Sector Council's concern and special expertise, in April 1984, the Committee's staff requested the PSC's Research Center to undertake this pro bono study.

The purpose of the study was to review and make specific, fact-based recommendations and suggestions for modifying, enhancing or eliminating statutes and regulations affecting Federal credit (direct and indirect) and cash management policies in ways that would improve Federal financial operations and contribute to reducing the deficit. No attempt has been made in this report to quantify the dollar value of such a reduction. To do so would require making several broad assumptions which could detract from the report's usefulness.

The result is an enumeration and discussion of citations whose alteration would implement the recommendations of other studies that form the base documents from which this research stems. They are:

> The President's Private Sector Survey on Cost Control (PPSSCC), primarily its Task Force Report on Financial Asset Management (FAM), May 1983. (Referred to as FAM Asset.)
>
> Government-Wide Standards for Credit Allocation, Risk Analysis and Loan Write-off Policies and Procedures. McManis Associates, Inc., November 1983. (Referred to as McManis Report.)
>
> Special Analysis F, Budget for FY85.

OMB Revised Circular A-70, Federal Credit Policy.

The Debt Collection Report of 1981, Office of Management and Budget

Debt Collection Act of 1982 - P.L. 97-365.

New Approaches to Budgetary Treatment of Federal Credit Assistance, Congressional Budget Office, March, 1984.

Format

For each major heading, an issue statement was developed from the base documents. This asks: What is the nature of the problem? The base document may be referenced for a more detailed discussion of the problem, its background, and the original findings.

The second question, under Citations, asks if the problem exists because of statutory or regulatory constraints, and if so, what these specific constraints are and how they are identified. It was found in the majority of cases that what the statute or regulation does not say appears to greatly influence management of the government's financial operations, because the absence of a permissive provision was invariably treated as prohibition by the loan program managers.

Finally, for each issue, the report makes observations about the broad processes required for solution of the problem. Here again, the report follows the recommendations in the base documents, but does not express an opinion as to their practicality. If the identified problem can be solved by changing the statute or regulation, that fact is cited and corrective language is suggested. If the recommended solution is not impeded by law or regulation, that fact also is stated, and suggestions are made for control and improvement of the credit program.

The matrix at the end of this report shows the degree of regulatory or statutory impediment for each program and indicates clearly that law and regulation seldom interfere with sound financial management.

Scope

In Fiscal Year 1983, direct loan obligations were $41.4 billions, and guaranteed loan commitments were $97.2 billion, with a total credit budget of $138.6 billion. The total outstanding Federal credit at the end of 1983 was $848 billion. The FAM report cites the financial impact on the economy of programs of such magnitude, but the task force's comprehensive review of the dollar savings was, of necessity, incomplete because of deficiencies in Federal accounting, management information systems, and definitions. Nevertheless, financial savings of ~~a~~ very high order are possible given the management controls recommended here.

Process

The researchers who contributed to this report reviewed approximately 450 statutes and regulations dealing with loan and loan guarantee programs. They conducted 35 interviews and filed 138 preliminary document reports. This research covers 13 Federal agencies whose outstanding loan receivables, guarantees, and obligations exceed 82 percent of all Federal credit. Legal research was coordinated by the Director of Research, who had been the principal author of the FAM report section dealing with Federal credit programs.

The research format follows the Research Center standards, and all references are supported by backup working documents which are available upon request.

The issues selected from the base documents are those reviewed and approved by the Senate Budget Committee staff.

By broad title, these issues are:

Credit Management: Marketing emphasis vs. management emphasis

Credit information system

Risk analysis

Credit eligibility/credit elsewhere

User fees

Interest subsidies

Direct vs. guaranteed loans

Extent of loan guarantees

Sunset legislation

Budgetary treatment of credit programs

Loan disbursements

Definition for collection activities

Reporting delinquent debts

Repayment periods

Cash management

Interest and penalties on late payments

Loan forgiveness

Performance standards

Use of Report

The Research Center anticipates that this report can be useful in at least three ways:

1. To amend, rewrite or eliminate language in statutes and regulations which inhibit sound credit management.

2. To train and educate those outside of government on the workings of government finance. To accomplish this, we envision publishing separate papers on several of the issues, expanding the description of the problem, its background, solutions, and impact.

3. To develop omnibus legislation dealing with the overall management of Federal credit and finance systems.

PART III--BACKGROUND FOR FEDERAL CREDIT PROGRAM AND IMPROVEMENT EFFORTS

Dollar Magnitude

In the past decade, Federal credit activity - direct loans, guaranteed loans, and government-sponsored enterprise loans - has expanded rapidly. In 1983, Federal net lending (disbursements of new loans less repayments) was $86.5 billion compared to $25.5 billion in 1974. The estimates for net lending in 1984 and 1985 were $88.5 billion and $94.8 billion, respectively.

In 1983, direct loan obligations were $41.4 billion, and guaranteed loan commitments were $97.2 billion, with a "credit budget" total of $138.6 billion. For 1984, the credit budget was estimated to be $135.3 billion, and the Administration proposed $130.5 billion for 1985.

The total outstanding Federal credit at the end of 1984 was estimated to be $936.4 billion and at the end of 1985 to be $1,031.4 billion.

Brief History

A series of General Accounting Office (GAO) reports beginning in October 1, 1978 highlighted the necessity of improving the government's debt collection processes. The first report, "The Government Needs To Do A Better Job of Collecting Amounts Owed by the Public," (FGMSD-78-61, dated October 20, 1978), indicated that improvements were needed in recording, billing and collecting accounts receivable. The next report, "The Government Can Be More Productive In Collecting Its Debts By Following Commercial Practices," (FGMSD-78-59, dated February 23, 1979), revealed that debt collection in the Federal government is a slow and expensive process with significant potential for improvement.

A special hearing was held on March 20, 1979, before the Senate Subcommittee on the Legislative Branch of the Committee on Appropriations to review ways in which Federal agencies can improve their debt collection practices. This hearing surfaced additional concerns over government debt collection practices.

In response to the issues which had been raised by GAO and the Senate Subcommittee, OMB issued a memorandum to heads of departments and agencies in March 1979 requiring each agency to review its procedures for collecting accounts receivables. In May, 1979, the OMB Financial Priorities Program was established and debt collection was included as one of nine key financial improvement areas which would receive comprehensive OMB oversight and review

Debt Collection Project

By August, 1979, it became apparent that the government's debt collection problems were both complex and serious and that an in-depth, thorough, agency-by-agency review was needed of both credit management and debt collection practices in the government. Accordingly, the Debt Collection Project was created in August 1979 within the Office of Management and Budget (OMB) under the sponsorship of the President's Management Improvement Council. It was determined that the Project would both work with the individual departments and agencies to establish effective collection procedures, and also identify goverment-wide problems which impeded agency collection efforts and make recommendations for solving these problems.

In January 1981, a report titled, "Report on Strengthening Federal Credit Management," was issued by the Debt Collection Project. A series of significant findings and recommendations were cited in the report, and the implementation and follow through on the recommendations are today the basic mission of the Debt Collection Project of the OMB under the guidance and sponsorship of the President's Management Improvement Council. The Debt Collection Project is aggressively pursuing improvements in debt management with cooperation of the operating agencies.

President's Private Sector Survey on Cost Control

On June 30, 1981, President Reagan issued Executive Order 12369 formally establishing the President's Private Sector Survey on Cost Control (PPSSCC). Briefly, the PPSSCC was given the mission to identify opportunities for increasing efficiency and reducing costs, to determine areas for enhancing managerial accountability and improving administrative control, and to suggest short and long term managerial operating improvements in the Federal government. PPSSCC was manned by private sector executives and experts with no cost to the Federal government. It was organized into 36 task forces, 22 of which were assigned to study specific departments and agencies and 14 to study functions cutting across or common to departments and agencies.

One of the task forces focused on the review of "financial asset management" covering government management systems to collect and disburse funds, to manage debt owed to the government, and to operate program loans. The task force made a series of recommendations that represent significant opportunities for improving fiscal management in areas of cash management, debt collections and credit management. Many of its key recommendations were focused on overall management operations and designed to institutionalize long-range solutions to problems identified.

Debt Collection Act of 1982

On October 25, 1982, President Reagan signed the Debt Collection Act of 1982. The act gave Federal agencies the ability to more aggressively pursue debts owed to the Federal government by individuals. With certain conditions, the Act, among other things:

--Allows agencies, except the Internal Revenue Service, to disclose information about an individual's debt to credit bureaus.

--Authorizes agencies to collect overdue payments from Federal employees through deductions from their paychecks.

--Permits agencies to obtain from the Internal Revenue Service current addresses of individuals owing money to the government.

--Authorizes the Internal Revenue Service to disclose to a requesting agency whether an applicant for a Federal loan has a delinquent tax account.

--Extends to 10 years the 6-year statute of limitation applicable to agencies in collecting debts by administrative offset.

--Requires agencies to charge a minimal rate of interest, as well as penalties and administrative charges, on delinquent nontax debts.

--Authorizes agencies to contract for debt collection services. With the passage of the Act, the agencies will now be able to use some of the tools that the private sector uses to administer its collection program.

In accordance with the Act, agencies are now required to report to Treasury and OMB on the status of their receivable program on an annual basis. Similarly, OMB is required to report to the Congress on the management of agency debt collection activities. The Debt Collection Project staff at OMB worked very hard to assure that this legislation was passed and to implement its provision.

In September, 1983, the Office of Management and Budget issued a Bulletin 83-29 concerning the implementation of the Debt Collection act of 1982 and the use of credit reporting agencies.

This Bulletin, in complying with the Act, required government agencies to release information on individual nontax consumer debt delinquencies to private sector credit reporting agencies. It also allowed an exchange of such information with other government agencies. And where they serve a useful business purpose, credit reports were to be obtained prior to making loans, serving as guarantor, or awarding a grant.

This new policy (1) provided an incentive for debtors to repay delinquent debts instead of receiving bad credit ratings, and (2) enabled agencies to improve their credit, contract, and grant decisionmaking process by considering applicants' credit ratings.

The Bulletin required executive agencies to take certain actions by November 30, 1983. Agencies were required to report commercial debts and delinquent consumer debts to credit reporting agencies and establish procedures for using credit reports as part of the decisionmaking process when awarding a loan, loan guarantee, contract, or grant.

"McManis" Report

In the summer of 1983, the OMB and Treasury sponsored a survey of Federal loan programs in an effort to obtain baseline information on them. Information from the survey was to be used (1) to understand the operational procedures of different loan programs, (2) to develop overall Federal policies on loan programs, and (3) to develop generic policies for different types of loan programs in the areas of required (uniform) management information, credit and risk analysis, collection policies, and procedural guidelines. The results of the survey led to significant conclusions and recommendations that were presented in a report titled, Government-Wide Standards for Credit Allocations, Risk Analysis and Loan Write-Off Policies and Procedures, prepared by McManis Associates, Inc., in November, 1983.

Deficit Reduction Act of 1984

Although the Deficit Reduction Act of 1984 addresses primarily the subjects of deficit reduction and tax reform, it does authorize the Department of Treasury to prescribe the mechanism to be used by Federal agencies to collect nontax debts and the time frames for deposit of these funds. Under the present law, Federal agencies may collect receipts through various collection mechanisms ranging from over-the-counter bank deposits to wire transfers.

New OMB Guidelines

In August, 1984, OMB issued a revised Circular No. A-70, "Policies and Guidelines for Federal Credit Programs." The revised A-70 is to be used in proposing or reviewing legislation related to credit programs, in evaluating congressional and other proposals on credit, and in reviewing existing or proposed credit program policies and procedures. Specifically, the Circular:

--requires credit legislative proposals to contain an explicit statement of any subsidies in direct or guaranteed loan programs;

--provides that interest rates on new direct loans be related to market interest rates, and vary with market conditions, rather than remain at static levels that become outmoded when market realities change;

--opposes providing direct or indirect Federal guarantees for Federally tax-exempt obligations;

--requires those receiving Federal loan guarantees to pay for part or all of the expected Federal default liability on the guaranteed loans; and

--encourages risk sharing with the private sector by offering less than 100 percent Federal guarantees rather than the full guarantee frequently used now.

In addition, OMB is in the process of preparing another Circular, titled "Managing Federal Credit Programs." The purpose is to establish standards for agencies to follow in managing several phases of the credit cycle including credit extension, account servicing, debt collection, and write-off.

PART IV--DISCUSSIONS OF SPECIFIC ISSUES

Credit Management: Marketing Emphasis vs. Management Emphasis

Issue:

Credit management consists of several distinct functions: application, review, disbursement, servicing, and collection. None of these functions operates in isolation. If any weakness exists in a function within the process, the total system becomes less efficient. Highly efficient loan origination, for example, is of limited value if little attention is paid to servicing and collection.

The Federal credit management systems have several weaknesses in this credit chain. Political and administrative pressure to process applications, approve loans and disburse funds is strong. Loan program managers are concerned with getting funds into the hands of borrowers quickly and easily to discharge what they see as their prime responsibility. There appears to be less pressure to assure that loans are appropriate and risk worthy and to monitor and collect these loans properly. The emphasis is on "marketing" - accepting applications, approving loans and disbursing funds. "Management" of outstanding loans, in the form of servicing and collection, receives much less attention. (FAM Asset 26, McManis Report #IV.) The basic concept needs to be accepted that the credit process is an entire system and not a series of unrelated functions.

Citations

Few legal barriers stand in the way of implementing improved credit management practices. In a few instances, existing legislation requires performance of certain practices. The Department of Education is required, by statute, to provide student loans at a fixed, subsidized rate [20 U.S.C. #1077 (a)]. This legislatively mandated credit practice binds the Department to a degree of inefficiency in its loan program regardless of the efficiency of the other phases of its credit process.

In the majority of programs, there are few barriers to effective credit management. For example, setting of interest rates on Farmers Home Administration (FmHA) loans is left to the discretion of the Secretary of Agriculture (7 U.S.C. #1927 (a) (4). Under this statute, no impediment to credit reform exists. Beneficial adjustments to the credit process can be modified without legislative approval.

Solution

The credit management process could be improved by comparing present Federal practices with those used in the private sector. Those practices that increase efficiency without interfering with the effectiveness of the program should be adopted by Federal agencies (FAM Asset 12). Basic concepts such as risk analysis (McManis #VI), interest rates (FAM Asset 15), and definitions of default (FAM Asset 16) should be considered using current private sector practices, in order to create greater efficiency in the overall credit process. Managing loans before and after disbursement helps to ensure that:

a. program intent is carried out more effectively;

b. an early warning system is created; and

c. delinquencies and defaults become less of a burden to both the government and users of Federal credit.

Credit Information System

Issue

Federal credit management can be improved substantially by establishing adequate and reliable information systems. Private sector expertise can be used to improve Federal management information systems.

The government does not have uniform standards for collection and storage of information regarding borrowers and outstanding loans. It is often impossible to gather this information to assess an entire credit program or to share information on outstanding loans with other agencies administering different credit programs. In effect, each loan and loan program is considered in isolation, because there is no means for compiling standardized information and interpreting it through the use of standardized definitions.

Citations

No statutory or regulatory impediments stand in the way of implementing information gathering. An initial expense for new information management equipment may be required. In addition, credit managers will have to go through a period of training and readjustment to new procedures.

Solution

Improvement of credit management could begin with the creation of a standardized management information system. Reporting requirements would provide basic information on all borrowers and outstanding loans (FAM Asset 12). Additionally, a central clearinghouse would be established for storage of and accessibility to this required information (McManis Report, IV). Part of this credit information could be a risk rating determined by applying a standard formula which gives an objective judgment of a borrower's credit worthiness (McManis Report, VI).

Risk Analysis

Issue

Another way to improve Federal credit management is by establishing adequate and useful risk analysis standards. Practices in the private sector are far more advanced and sophisticated than those being used by Federal credit managers (McManis Report, #VI, Portfolio Risk Management). Private sector expertise can be used to improve risk analysis.

The government does not have uniform standards or standard definitions for risk rating of individual loans and risk analysis of a loan portfolio. In effect, each loan and loan program is considered in isolation, because there is no means for compiling standardization information and interpreting it through the use of standardized definitions. At one extreme, lack of a credit worthiness standard in a program, such as the Department of Education's Guaranteed Student Loan (GSL) and National Direct Student Loan (NDSL) programs, allows borrowers who have poor financial standing and a limited ability to pay to receive loans regardless of their credit worthiness. The effect of this deficiency is reflected in the high default rate on such loans.

Citations

No statutory or regulatory impediments stand in the way of implementing risk rating and risk analysis systems. Credit managers will have to go through a period of training and readjustment to new procedures.

A risk rating determined by applying a standard formula which gives an objective judgment of a borrower's credit worthiness should be made a part of the credit information system (McManis Report, VI). One simple example would be a scale from "1" to "10". A borrower rated "1" would be financially strong and considered the best credit risk. A "10" would be financially weak and considered the worst credit risk. Such a rating could be used in making an initial decision whether or not to grant a loan, what type of loan should be given, and what level of subsidy might apply.

It is important to note that the risk rating is an entirely objective standard involving no policy judgment. The rating reflects only the borrower's financial status and ability to repay. Each agency must apply its own policy standards against the rating in determining the applicant's eligibility for credit. For instance, a rating of "8" might be acceptable in granting a direct loan for housing to a low-income borrower, whereas the same rating might be unacceptable if the borrower is seeking a loan guarantee to establish a business.

Policy decisions may be made only by the Congress or delegated to the discretion of an agency by statute. Accordingly, a risk rating cannot have any substantive effect on policy. It is designed only to be a means of assimilating diverse information on a borrower's financial status into one efficient and practical form to which policy determinations may be applied.

The risk rating should also be used to monitor the financial status of "large" borrowers with outstanding loans. A borrower whose rating improves could be required to refinance the loan without Federal assistance. If the rating deteriorates, steps would be taken to reschedule the loan on terms more suitable to the new facts.

Finally, the risk rating system could be used as part of an overall risk analysis system. By accumulating and analyzing information available through the central clearinghouse, the performance of credit managers or the efficiency of credit management practices could be judged continually.

Improved risk analysis would require new credit training programs to upgrade the technical skills of all lending, credit review, and credit servicing personnel (FAM Asset 12).

Once such programs were in place, performance incentives could be introduced in each agency (FAM Asset 12). This incentive program could be administered either through upper-level officials at the agency, or through the Office of Personnel Management. Implementation of this combination would increase the efficiency of all phases of the Federal credit process.

Analyzing and tracking risk during the life of a loan is the only means by which the Federal government can truly determine the real value of its enormous portfolio of credit assets. This report suggests later that cash can be generated through the sale of loans receivable. The price paid for such assets, while a factor of both rate and term, is also influenced by the borrower's past behavior. Continuous analysis of credit risk as it changes over time can positively influence selling price.

Credit Eligibility/Credit Elsewhere

Issue

A role of the Federal government credit programs is to act as lender of last resort. Accordingly, the government should not extend credit if sufficient financing is available in the private sector and a borrower can obtain credit from private sources. However, through statutory requirements or administrative guidelines, Federal credit programs do serve certain borrowers who are low credit risks.

Citation

Some agencies, such as the Rural Electrification Administration (REA), interpret legislation authorizing their credit programs (7 U.S.C. §902) as requiring them to make loans to all eligible borrowers regardless of their financial strength and ability to obtain credit elsewhere. Other agencies, such as the Farmers Home Administration (FmHA), are required by statute to consider the borrower's ability to obtain credit elsewhere:

> "be unable to obtain sufficient credit elsewhere to finance their actual needs at reasonable rates and terms, taking into consideration prevailing private and cooperative rates and terms in the community in or near which the applicant resides for loans for similar purposes and periods of time."
>
> (7 U.S.C. §1941(a)(4)

The lack of a credit eligibility or credit elsewhere test in the REA's authorizing legislation has led to an interpretation that all borrowers eligible under the general mandate may receive loans regardless of their strong financial condition and ability to repay.

Solution

Credit eligibility and credit elsewhere tests could be implemented by statute, since the absence of such tests leads to the interpretation that loans should be granted to all applicants. Credit eligibility and credit elsewhere tests could be designed, implemented, and audited to ensure that Federal loan programs are targeted at borrowers who are unable to obtain credit elsewhere and possess some reasonable prospect of repayment (FAM Asset 25).

User Fees

Issue

No standard policy exists for charging of origination fees, loan fees, and guarantee fees. In the private sector, certain administrative costs are often collected as an up-front fee charged at the time the loan is made. The majority of government credit programs do not require such fees.

Citations

The REA is prohibited by statute from assessing a fee or charge for any guarantee, accommodation, or subordination (7 U.S.C. §936). In other instances, lack of any statute authorizing a fee or charge and setting specific rates or means for determining rates has been interpreted as preventing the agency from assessing fees and charges.

Other statutes authorize fees and charges at the agency's discretion. For example, FmHA is authorized, but not required, to collect payment of fees and charges [7 U.S.C. §1927(b)].

Solution

A nonrefundable application or origination fee could be assessed for all loans based on allocation of operating costs involved to initiate and service the loan for its term (FAM Asset 11). Such fees could be set by reference to a benchmark fee or insurance premium charged by private sources for similar types of guarantee or insurance coverage to similar kinds of borrowers against similar types of risks [OMB circular A-70, §10(b)(2)]. At present, since fees may be required, authorized, or prohibited by statute, the most effective means of implementing a uniform system of fees and charges would be enactment of omnibus legislation requiring application or origination fees on all loans and loan guarantees (FAM Asset 11).

Interest Subsidies

Issue

Interest rates on Federal loans are established to serve one of two purposes. Some programs charge a rate of interest that allows the government to recover its cost of borrowing. Other programs provide a subsidy for the borrower by setting an interest rate below that available from private lenders and below the government's cost of borrowing. Once a policy decision has been made as to the purpose of the interest rate, this intent is reflected in the statutory language authorizing the program. The problem with setting rates in this manner is that changes in financial markets can cause the actual effect of the rate to be far different from that originally intended by Congress. Generally, legislation binds agencies to a fixed rate, a fixed subsidy, or an interest formula.

Citations

Certain statutes stand directly in opposition to any change in interest rates, and many programs face statutes mandating fixed interest rates. The interest rate on REA-insured loans is fixed at 5 percent [7 U.S.C. #935(b)]. The interest rate on Department of Education National Direct Student Loans (NDSC) is fixed at 5 percent [20 U.S.C. #1087 dd(c)]. The rate on Guaranteed Student Loans (GSL) made by private lenders and guaranteed by the government is fixed at 9 percent for all new borrowers [20 U.S.C. #1077(a)].

Other less restrictive statutes allow rates to be set at the agency's discretion. The rate on FmHA real estate and farm operation loans is determined by FmHA, but may not exceed the government's cost of borrowing plus 1 percent [7 U.S.C. #1927(a)(d)]. The Commodity Credit Corporation (CCC) is authorized by a charter [15 U.S.C. #714(b)] which makes no mention of interest rates, rate formulas, or interest subsidies.

The CCC thus has set up its own formula for interest rates on commodity loans, grain reserve loans, and farm storage facility loans. The initial interest rate on CCC loans is set at the rate of interest charged CCC by the U.S. Treasury during the month the loan is disbursed. The rate of interest on outstanding loans is adjusted each January 1 to reflect the rate of interest that the Treasury charges CCC for its borrowing for the month. This formula assures the CCC recovery of its cost of borrowing without providing an unintended subsidy to the borrower (CCC docket FCZ-247, Revision 2).

Alternatives have been suggested for interest rates, subsidies, and interest formulas in new guidelines published in OMB's revised circular A-70. Under these guidelines, all interest rates and subsidies are to be tied to a "benchmark financial instrument," which takes into account the cost of alternative private financing available to actual or potential borrowers for the transaction being proposed. Interest rates would be pegged at this rate, and the subsidy calculation would be on a discounted basis (OMB A-70 #10).

Another proposal was made by the FAM task force. The desired or intended subsidy level of each program would be determined, with the total subsidy level defined as the intended rate point spread below current market rates. The government cost of a direct subsidy would then be the difference between the total point spread (subsidy) and the premium of the market rate over Treasury's current cost of funds (FAM Asset 15).

Solution

Unintended oversubsidization exists, and a move to floating interest rates would bring about a return to the initial intent of the program without a substantive cut in the subsidy level. Interest rates should not be fixed at one specific rate, but should be pegged to a financial index and allowed to float as financial markets fluctuate. Sound alternatives exist in OMB circular A-70, the CCC's present policy, and the FAM recommendations. Fixed rates and rates set at agency discretion could be replaced by a uniform, government-wide policy. The most viable solution would be adoption of omnibus legislation requiring that interest rates on all government loan programs be pegged to some widely traded financial instruments.

Direct vs. Guaranteed Loans

Issue

When borrowers are such credit risks that no private lender would be willing to extend credit on reasonable terms, government assistance should take the form of a direct loan (FAM Asset 13). Where the borrower is a marginal credit risk, the risk can be shared by the government and the private lender in the form of a guaranteed loan. However, many agencies are servicing these risks with direct loans, even though loan guarantees would be a more efficient and equally effective form of assistance.

Citations

Many agencies deal mostly with borrowers who can be classified as marginal risks. For example, SBA is authorized to make direct loans for small business purposes (15 U.S.C. §636). This statute is interpreted as allowing SBA to accept credit risks that are often unacceptable to the private sector. But a conflict exists because SBA is not authorized to make government loans for projects that appear to be unfeasible at the outset (which is the determination the private lender made). Further, SBA sees its function as guaranteeing loans made by private lenders to entrepreneurs who are considered to be marginal risks (FAM Asset 18).

The same theory applies to FmHA loan programs. FmHA is authorized to make direct loans for business and industry [7 U.S.C. §1924(b)], farm ownership (7 U.S.C. §1922), and farm operation (7 U.S.C. §1941). FmHA extends loans to those who are "unable" to obtain sufficient credit elsewhere to finance their actual needs at reasonable rates and terms [7 U.S.C. §1941(a)(4)]. Strict interpretation of this statute would require that FmHA provide direct loans regardless of the degree of the borrower's credit risk. However, a more reasonable approach would require FmHA to provide only guaranteed loans to borrowers who are marginal credit risks.

The REA direct loan program also suffers from this general problem. REA was originally established to provide direct loans to help improve rural electrification (7 U.S.C. §902). This statute has a longstanding interpretation of allowing REA to provide direct loans to all concerns involved in rural electrification. REA makes direct loans not only to marginal credit risks, but also to financially sound borrowers who are considered by private lenders to be "bankable" credits.

Direct and guaranteed loans are also provided to both sound and marginal credit risks under the Department of Education NDSL and GSL programs.

Legal impediments stand in the way of reforming these programs. Loan terms often are set by law. Little or no differentiation is made between strong, marginal and high credit risks. This lack of guidance is present in most direct loan programs (REA, FmHA, SBA) and in certain guaranteed loan programs (GSL, Eximbank). These statutes and their present interpretation oppose the principle that high credit risks should not receive direct loans and marginal risks should receive guaranteed loans.

Further direct loan programs administered by SBA, FmHA, and REA could be phased out and replaced by guarantee programs. Exclusive use of loan guarantees, rather than direct loans, creates a more efficient system. The borrower who is rejected as a marginal or high risk by the private lender may still be able to obtain a loan. Government benefits when direct loans are replaced by guaranteed loans, since it is able to shift loan origination, servicing, and collection functions to the private sector which has both expertise and facilities to perform these functions.*

*A discussion, outside the scope of this paper, relates to the benefit of substituting guaranteed forms for direct lending as it bears upon the "crowding out" effect in capital markets.

Solution

A more consistent policy should be established that would enable loan programs to be more flexible in providing loans or loan guarantees as appropriate and consistent with borrower's credit risks. Further direct loan programs administered by SBA, FmHA and REA should be gradually phased out in favor of guaranteed loan programs.

Extent of Loan Guarantees

Issue

In most guaranteed loan programs, the private lenders bear little or no risk with the government assuming all or almost all of the risk involved. Accordingly, the private lender does not have much incentive to provide adequate loan servicing and collection. Further, where private lenders are required to assume some risk, the percentage rates vary among programs.

Citations

At present, SBA is required to extend guarantees of at least 90 percent of the loan amount for all loans under $100,000 and between 70 and 90 percent for all loans between $100,000 and $714,000 [15 U.S.C. #636(a)(2)]. FmHA is authorized to guarantee up to 90 percent of business and industry loans (C.F.R. #1980.20). Statutes without any reference to the percentage that can be guaranteed are generally interpreted as authorizing guarantees of 100 percent of the loan amount (REA).

Where 100 percent of the loan is guaranteed, the private lender has no incentive to conduct adequate loan servicing and collection. The lender's most efficient course of action is to pursue the minimum functions required by the agency and quickly return defaulted loans to the agency for payment. Even where the guarantee is limited to 90 percent of the loan amount, the 10 percent that the private lender stands to lose often does not provide sufficient incentive to service the loan properly.

Greater incentive to perform proper loan servicing and collection on guaranteed loans would be created if guarantees on all government loans were limited to a figure lower than 90 percent (FAM Asset 21). Loan guarantees could be structured so that private lenders bear a significant portion of the risk of loss from default. "Significant" is defined as equal to or greater than 20 percent of the loss stemming from default [OMB Circular A-70 #10b(3)]. This proposed structure could be mandated on all guarantee programs by adopting omnibus legislation.

Also, agencies providing guaranteed loans could increase efficiency by instituting "certified lender programs" (FAM Asset 20). Under this type of program, the private lender performs all loan origination, servicing, and collection functions. The lender is allowed to effect a government loan guarantee without agency approval. The agency is responsible for monitoring, auditing, and reviewing the program to ensure that government guarantees are being given only to borrowers who are defined credit risks. Lenders who do not comply with agency standards could be dropped from the government guarantee program. The agency steps into the actual credit process only when a loan goes into default. SBA is authorized by statute to delegate loan making, servicing, and collecting functions to private lenders [15 U.S.C. #634(b)(7)]. The "certified lender program" has proved successful, and similar delegation to private lenders should be authorized in all agencies administering guaranteed loan programs through omnibus legislation.

Solution

Private lenders should be required to bear a greater share of risk on guaranteed loans. That share, to be effective, should be at least 20 percent. Also, "certified lender programs" should be explored and authorized for all guaranteed loan programs.

Sunset Legislation

Issue

Federal credit programs have strayed from the original intent of their authorizing legislation. Most credit programs were designed to solve a specific problem or a financial condition that may no longer exist. However, once in place, the momentum of these programs tends to make them self-sustaining, even though the purposes behind the programs and the way they are implemented may no longer be practical. Over time, many programs expand rather than diminish in scope.

For example, the REA was established in 1936 to deal with the lack of electricity and telephone service in rural areas. In 1981, over 99 percent of the country was served by electricity and telephone services, yet the REA made $1 billion in direct loans that year.

Credit programs and practices are allowed to expand or to become outdated or even obsolete because there is no means for periodical review by Congress. Only legislation can change or terminate a program or practice mandated by statute. Without some mechanism for periodic review, political and administrative pressure often maintains credit programs well beyond their practical life.

Citations

Sunset provisions subject credit programs or entire agencies to termination at a specific time. This type of statutory language has been used only recently, so that few statutes authorizing credit programs contain sunset provisions. One example of existing sunset legislation is the Synthetic Fuels Corporation which "shall terminate on September 30, 1997" [42 U.S.C. §8791(2)]. The majority of Federal credit programs are not subject to sunset provisions.

Solution

Legislation could be introduced requiring that all new bills creating credit programs contain a sunset provision whereby the program would automatically expire at the end of five years. This legislation could also place a maximum of five additional years on all existing lending programs.

Budgetary Treatment of Credit Programs

Issues

The actual costs of government loan programs are not accounted for and measured in the budgetary process (unified budget), because of the current budget accounting procedures for Federal credit assistance programs. This problem has two components. First, the law currently requires that the Federal Financing Bank (FFB) lending activities be excluded from the budget. Secondly, for those programs that are included within the budget totals, current accounting procedures use a net cash outflow (disbursements of new loans less repayments) as a basis for costs. The true costs of loan programs, such as interest subsidies and loan losses, are also not properly recorded in the budget. Consequently, overall management of Federal credit activity is hampered.

Citations

New Approaches to Budgetary Treatment
FAM Asset 31.
Special Analysis F, the Budget of the U.S. Government, FY 1985

Solution

Inclusion of the FFB within the unified budget would permit an accurate reporting of the actual amount of the government's credit activities. Current practices allow the agencies to use the FFB as an off-budget source of funding (in addition to regular on-budget funding) by selling receivables due the agency through certificates of beneficial ownership. Thus, the agency shows reduced net outlays as it recovers its monies from FFB and the loan is now off budget. The agency's guarantee risk remains unrecorded. 12 USC #2290 could be amended to include the FFB's activities within the unified budget.

Special Analysis F, Budget of the United States Government for fiscal year 1985 provides:

> "The unified budget should be made more inclusive of Federal credit activity by including the "off-budget" outlays of the lending programs financed through the Federal Financing Bank (FFB), with appropriate safeguards to prevent agencies from financing outside the FFB to avoid being included in the budget. Congressional action on credit should be subject to the same Congressional budget procedures and control as outlays. This would significantly improve control over Federal credit activity beyond the current process of setting limitations on direct loan obligations and guaranteed loan commitments in appropriation bills. The Federal credit control system would be improved by having the Congress establish binding aggregate limits on new direct loan obligations and guaranteed loan commitments in the budget resolutions and incorporating these limitations into the reconciliation process. The budget reconciliation process would require that credit totals be allocated by committee, analogous to the process for the unified budget."

Some resistance can be expected for placing the FFB in the unified budget, because it would aggravate the deficit situation. Off-budget or unified budget, expenditures are government expenditures and some of them should not be hidden under the guise of "off-budget" technicalities. The important thing is to get a proper visibility and management control on Federal credit activities from an overall management standpoint.

Further, to accurately reflect the true costs of loan programs requires the separation of loan funds from loan costs. The CBO study of New Approaches to Budgeting Treatment suggested four potential methodologies to correct this. Two of the proposed methods, the market plan and the appropriations plan, seem best suited to serve this purpose. The two could be combined or adapted to best match the purpose of this goal with the realities of the marketplace and the budgetary process.

The market plan involves a requirement to resell all government loans to private investors soon after they are made and to reinsure all insurance and guarantees with private sellers. The appropriations plan involves an estimation of the present value of the subsidies covered by current year obligations and commitments. An annual appropriation equal to that estimated amount would be made to the loan program. Both methods attempt to isolate the pure subsidy cost of the government's credit transactions.

By measuring the costs of loan programs, a spending equivalent budget measure is determined. This would then allow comparisons between credit activities and direct spending programs for cost effectiveness and viability of the respective programs. Legislative intent would then be better served as true costs and subsequent benefits created are measured accurately.

Creating the necessary procedures to measure loan program activities and costs accurately would aid the goverment in better controlling its spending costs and better reflect the Federal government's total credit activities.

Loan Disbursements

Issue

The government's costs for loan funding are greater than necessary because of overly generous funding policies. It incurs higher costs by making premature loan disbursements in the form of advance loan funding. In addition, the government pays interest subsidies on guaranteed loans that have not yet been actually disbursed by the lending institutions. This usually involves situations in which multiple disbursements are allowed. The lender is essentially receiving free money, because it has not expended part of the amounts on which it is receiving subsidies.

Citation

PPSSCC Education Task Force (Ed 4), (34 CFR 682.304), FAM Asset 12.

The methods currently in use for loan disbursement in a student loan program of the Education Department allow the lending institution to disburse funds semi-annually, once in the fall and once in the spring. Yet, the bank receives funds based on the entire loans as of the first payment. The bank retains half of the monies for five months, but it is receiving interest and subsidies on those funds. The Health Education Assistance Loan Program is an example of a program that is designed to avoid such practices.

Solution

It is recommended that, for credit programs, a better cash management control be established that would: (1) time payment for loan programs based on actual need, and (2) calculate subsidies on loan guarantees based only on actual disbursed funds by the lending institutions.

Superior monitoring systems, greater use of electronic funds transfer, and movement toward stringent payment controls can all affect the payment schedule of direct loans. The goal is to defer payment until certified need by recipient to reduce government borrowing costs. This would also lessen the borrower's ability to invest government funds prior to their actual use.

The regulations could be amended to require that when possible, multiple disbursements be made mandatory, and secondly, that interest payments be made only on funds actually disbursed. These changes would immediately reduce the government's lending subsidy costs by lowering subsidies and deferring interest expense. A statutory rule prohibiting advance funding could also be adopted.

Definition for Debt Collection Activities

Issue

Debt owed the Federal government arises from thousands of transactions, the bulk of which are generated by loan programs. About 85 percent of the total $260 billion receivables due the government were loan receivables at the end of 1983 (The Budget for FY'85 Management Report, p. 216). The various components of debt collection are intertwined. For example, in order for agencies to assess charges and interest on a delin- quent debt, a "delinquency" must be defined. Some statements provide that defaults be reported but then do not define "default." There is a further lack of uniformity in reporting delinquent debts and in specifying repayment periods. The fol- lowing three issues deal mainly with the problems of definition.

Where definitions of terms necessary to perform the function of debt collection do exist, they are not uniform or specific (FAM, Asset 26). These terms include debt, write-off, and default.

Definitions in general are rare in the statutory language (McManis Report #3). Agencies are reluctant to define terms, although it is their province to do so. The General Accounting Office and the Justice Department have specifically declined to define delinquency and default in their proposed regulations to the Federal Claims Collection Act (Federal Register, Volume 49, Number 48, March 9, 1984). In addition, the Debt Collection Act of 1982, created to improve the government's debt collection efforts, does not define terms such as debt, deliquency, and default.

If definitions are given, they are usually found in the program's regulations, not its statutes, and they are not standardized. Unless uniform or standardized definitions are in place, even the most carefully designed practices and procedures for debt collection are compromised, and agency personnel do not know when collection efforts should be triggered.

Citations

There are very few impediments to creating standardized definitions for use with government loan programs. Below are some examples of statutory and regulatory provisions describing default and delinquency procedures, and definitions of delinquency and default.

An example of default and delinquency procedures is:

> 13 CFR Part 120.3 (SBA) - gives detailed loan servicing and loan monitoring instructions.

Examples of default and delinquency definitions are:

> 15 USC § 636(b) (3) (Air Pollution Control Program) - defines default as "a failure of the small business concern to make payment of the guaranteed amounts due within the time required under a qualified contract."
>
> 10 CFR Part 792.31(o) (Loans for Reservoir Confirmation Projects)--defines default as "the failure by borrower to make payment of the principal or interest in accordance with the terms and conditions of a loan issued under this part, or the failure of the borrower to meet any other term or condition of the loan agreement."
>
> 46 CFR Part 298.40 (Federal Ship Financing)--default is defined as a failure to make payment which has continued for 30 days.
>
> 42 CFR Part 57.216(a)--(Health Professions Education Loan Payment for Service in a Shortage Area)--Borrower and delinquency rates are defined; they may not be over 5 percent at any school receiving funds.
>
> 16 USC § 1271 (Fish and Wildlife Direct Loan Program)--Borrower's failure to conform to the Act, the regulations, or loan document shall be a default.

> 12 USC § 1713(g) (Mortgage Insurance Rental Housing)--default is defined as "failure of mortgagor to make any payment due under or provided to be paid by the terms of a mortgage insured under this section."

Solution

Definitions for delinquency, default, write-offs, documentation, and tracking of Federal debt associated with the lending process could be added to the Debt Collection Act of 1982. This would be a more efficient method of handling the lack of definitions than adding definitions to each lending program. Each agency that makes loans should be required to define common standards for delinquency and default to provide uniformity in definitions.

Reporting Delinquent Debts

Issue

Reporting of default is crucial since the older a debt becomes, the harder it is to collect. Deputy Assistant Attorney General Robert N. Ford, appearing before the House Subcommittee on Administrative Law and Governmental Relations, stated:

> "A collection program that cannot rely upon a swift judicial process, followed, if necessary, by an attachment of property, garnishment, or other seizures permitted by law, will adversely affect not only the likelihood of collecting claims referred to justice for litigation, but also the collection rates by the agencies in their pre-litigation efforts."

Since agencies do not have specific credit managers, various personnel are assigned to debt collection responsibilities (FAM Asset 26). Delinquent debts are not reported promptly to agency heads or other top management officials, resulting in greater difficulty in collecting the debt and inaccurate receivable records (FAM Asset 26).

Citations

Few statutes specifically state the time to report a default. The Department of Energy has several programs that require the reporting of a default. Two HUD programs require reporting of default without defining a default or giving a specific time limitation for reporting (12 USC #1749(aa)(Land Development and New Communities), and 12 USC #1709, 1715(b)(i) FHA Mortgage Insurance Premiums and Fees).

Listed below are citations indicating impediments to and examples of reporting defaults:

> 13 CFR Part 122.10 (SBA) Business Loans--allows up to one year for bank to make a claim with the agency to pay off a bad loan.

42 USC § 6211 (Incentive to develop underground coal mines - Cash and Guarantees)--requires that a nonpayment notice be sent by the lender to the Secretary of Energy within 30 days of a missed payment.

10 CFR Part 799.14(c)(3) (Alcohol Fuels Program)--requires the lender servicing the loan to notify the Secretary of Energy within 10 days of nonreceipt of a payment past due.

10 CFR Part 796.50(c)(3) (Loan Guarantees for Alternative Fuel Demonstration Facilities)--requires notice to Secretary within 15 days of nonpayment.

10 CFR Part 790.30(c)(3) (Geothermal Loan Guarantees)--requires notice to Secretary of Energy by lender within 10 days of missed payment.

Several other programs contain procedures to be used in case of default which include the reporting requirements or imply that a notification of default will discharge the assessment of a premium of the loan:

46 CFR Part 298.40, Subpart § (Ship Financing Fund)--contains detailed procedures to be used with defaults.

42 USC § 294(e)(c) (Health Professions Education Loan Payment for Service in a Shortage Area) (Health Professions Federal Capital Loan Program, HHS)--premium on a loan not payable if notice of default given. However, no specific time within which notice must be given is set by statute.

Solution

A standard should be developed for reporting defaults or delinquencies to agency heads or other top management officials within a specified number of days after they occur. This would improve receivable records and lead to sound and timely debt collection practices.

Repayment Periods

Issue

The length and beginning date of repayment on a Federal loan are often unspecified by regulation or statute, leaving agency officials uncertain as to the status of a debt and when to use agency debt collection practices. As a consequence, the Federal government's management of its loan receivables suffers.

Citations

Examples of citations specifying when repayment period begins are:

20 USC §1087 dd(c) (National Direct Student Loan)--repayment will begin six months after the borrower is no longer a student.

42 USC §297(b)(2) (Nursing Student Loans)--repayment shall be over a 10-year period beginning nine months after school ends.

42 USC §294 (Health Professions Education Loan Payment, Federal Capital Loan Program)--repayment begins one year after student ceases to be full-time student.

42 CFR Part 6011 (Health Education Assistance Loans)--repayment begins no earlier than nine months nor later than 12 months after the date on which borrower ceases to be in an accredited residency/internship program (§ 294.2(d)(b)).

42 CFR Part 60.11 (Health Education Assistance Loans)--provides for repayment over a period of not less than 10 years nor more than 25 years.

46 USC §1271 (Federal Ship Mortgage Insurance)--loan period of 25 years.

12 USC § 1749(c) (Group Practice Facilities Program, HUD)--repayment period for an educational institution may not exceed 50 years.

7 USC § 1927(a) (Business and Industry Loan Program, FmHA)--repayment period may not exceed 40 years

Solution

The beginning date for repayment on a government loan and the length of the repayment period could be specified in regulations or legislation. Statutes that do not mention repayment or give other guidance regarding servicing and collection of the loan may not be impediments to this solution, because they do not expressly forbid efficient repayment provisions. To implement this solution, numerous regulations would have to be amended or legislation passed requiring that all loan programs specify the length of the repayment and the date the repayment period begins.

Repayment periods should be no longer than necessary. Accelerated repayments could be investigated, taking into consideration the borrower's "ability to pay" instead of following arbitrary time limits in the statutes and regulations. (No calculation or rationale has been presented that we know of for any particular length of repayment period.) An "ability to pay" test is recommended by both the McManis Report and FAM Management Policies and Practices and the FAM Asset 12. Such a test assumes that the borrower's ability to pay back the money borrowed increases with time. Accordingly, the individual payments on the loan could be in increasingly larger amounts.

Cash Management

Issue

The value of prompt collection and deposit of the Federal government's receipts is obvious. It reduces the working capital requirements of the government, thus reducing the deficit. Methods used to repay a Federal loan are not specified by statute or regulation, and thus the most efficient methods of repayment are not in use.

Asset 2 of the FAM report recommends the use of lockboxes and electronic fund transfers to speed up the collection and deposit of receipts. Lockboxes and electronic fund transfers (EFT) have been used in industry and promoted aggressively by the banking community for the last 10 years. In 1976, with the establishment of the Treasury Financial Communication System (TFCS), it became possible to do online transfers of funds for both disbursement and collection.*

Provisions in the statutes of regulations outlining the method of billing or specific repayment procedure to be used might be viewed as impediments to recommend changes in the current repayment practices or programs, but such provisions are rare.

Citations

The following is an example of a statute that gives a specific day when a payment is due:

> 24 CFR Part 236.515 (Subsidized and Public Housing Programs, HUD)--payments are due on the first day of the month following the beginning of the term and shall be paid upon the receipt of a billing from mortgagee.

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* On October 1, 1984, Treasury's Bureau of Alcohol, Tobacco and Firearms instituted electronic transfer of large annual excise tax payments--a move expected to save the government $8 million a year in extra earned interest.

Solution

Since no specific statute or regulation was found that disallows either the Electronic Funds Transfer or lockbox method, there appear to be no impediments. A comprehensive bill specifying that lending programs require repayments through TFCS or lockbox, whenever feasible and appropriate, could lead to an acceleration of cash collections and a reduction in government borrowing.

Interest and Penalties on Late Payments

Issue

Except for the Internal Revenue Service, agencies historically have not assessed interest and penalties on delinquent debt. The Debt Collection Act of 1982 (P.L. 97-365) requires the head of an agency or his/her designee to charge a minimum annual rate of interest on delinquent debts that is equal to the original investment rate for Treasury tax and loan accounts. The charging of interest and penalties was also recommended by the FAM (Asset 29) and the Debt Collection Report, 1981.

The Debt Collection Act provides that the agency head:

a. Assess charges to cover costs of processing and handling delinquent claims; and

b. Assess a penalty charge on delinquent debt.

However, (a) and (b) are severely limited by subsection (c), which states that the interest and charges shall not apply if a statute, regulation, loan agreement, or contract prohibits them or fixes interest or charges. These prohibitions serve as impediments to debt collection procedures, because the charging of interest and penalties has long been thought to discourage late payments and defaults.

Citations

While authority for charging interest and/or penalties on late payments is often given to the Department Secretary, it is more common to find simple flat rates for penalties or late charges.

> 7 USC § 936 (Rural Electrification Administration)--prohibits fees and charges for any such guarantee...
>
> 7 USC § 1927(b) (Business and Industry Loan Program, FmHA)--Borrowers shall pay such fees and charges as the Secretary may require.

7 USC # 1927(b) (Real Estate Loans, FmHA)--FmHA is authorized to require payment of any fees and charges.

12 USC 115(e) (Investor-sponsored Cooperative Housing)--late charges are collected; delinquency and default are undefined.

15 CFR Part 1404.3 (Commodity Credit Corporation Farm Storage Loans)--late payment charge on the full amount of any delinquent debt assessed from the time the debt becomes delinquent if the contract or agreement specifies a late payment charge. If there is no such specification, the charge will be assessed on the amount due 30 days after the borrower has been informed of the charge (1403.3). Late payment charge will be expressed as a rate of interest (1403.3).

24 CFR Part 213.18(c) (Multifamily Mortgage Insurance Program, HUD)--late charge not to exceed two cents for each dollar of each payment to interest and principal more than 15 days in arrears (Part 234.550).

42 USC # 297(s)(F) (Nursing Student Loans, HHS)--penalties may not be more than 1% for the first month or part of a month.

42 USC # 294 (Health Education Assistance Loans, HHS)--Late charges may not exceed 5% of the payment due.

Other statutes and regulations are silent as to ensuring or prohibiting the collection of late penalties or interest charges on late payments.

Solution

Subsection (c) of P.L. 97-365 (Debt Collection Act of 1982) could be amended by giving specific exemptions as to when the charges or the assessment of interest on late payment may not be required. Another alternative could be to require programs that prohibit such a charge to outline the specific conditions of the borrower or the loan when this prohibition may apply. Finally, it is recommended that agencies and programs which do not require penalties or the charging of interest on late payments, and have no legislative prohibitions against such charges, introduce regulations to implement such penalties and charges.

Loan Forgiveness

Issue

Provisions for loan forgiveness are not clear or uniform, with the Department Secretary given total discretion in this area. Loan forgiveness is usually discussed as a "waiver of right of recovery." In other words, the government chooses not to collect the money it has lent to a borrower. Frequently, a statute or regulation mentions that forgiveness should be for "good cause," but good cause is seldom defined. The forgiveness of a loan essentially turns it into a grant from the agency to the borrower. The conditions or circumstances which may excuse the repayment of a loan are vague and give full discretion to the Secretary. Therefore, loan forgiveness provisions promote a relaxed approach on the part of agencies in their collection of debt. Furthermore, where loan forgiveness provisions exist, there appear to be no corresponding provisions outlining loan write-off procedures to be used.

Citations

The majority of loan forgiveness provisions in the statutes and regulations are found in Health and Human Services.

> 42 CFR Part 254(b)(1) (National Health Service Corps)--"where compliance would unreasonably limit the ability of the entity to provide for the adequate support of services," forgiveness may be allowed.
>
> 42 USC # 291 S-7(d) (Medical Facilities)--"for good cause," the Secretary may waive any right of recovery.
>
> 42 USC # 300 E-7(b)(3) (Health Maintenance Organizations)--Secretary may for good cause waive recovery right.
>
> 42 USC # 297(b)(j) (Nursing Student Loans)--Secretary may undertake to pay all or part of the loan of a person who received it and is obligated to repay.

A revised schedule for repayment under which payments by the borrower are defined is also found in Health and Human Services:

> 42 USC § 294 (Health Education Assistance Loans)--offers, by regulation of the Secretary, a schedule for repayment of the principal and interest under which a portion of the principal and interest otherwise payable at the beginning of the repayment period is deferred until a later time in the period.

Solution

Debts which are forgiven could be written off immediately by programs.

Revised repayment schedules and partial loan forgiveness already in place in certain HHS units serve as viable alternatives to forgiving the entire loan.

Provisions for loan forgiveness should be specific and uniform, under individual agency regulations or by comprehensive statute, i.e., if certain conditions exist, the borrower's loan may be forgiven.

Performance Standards

Issue

Performance standards that set goals and provide incentives for better debt collection are valuable system tools within a viable credit managment system.

At present, few agencies have established performance standards by which to judge their debt collection activities. Such standards of acceptable default levels, for instance, would enable agencies, OMB, GAO, and Congress to better judge the effectiveness of practices and procedures for repayment and debt collection.

FAM recommended that maximum acceptable default levels be established for each direct and guaranteed loan program (FAM Asset 16). Acceptable default levels encourage managers to concentrate on the collection of a debt as much as they do on the lending process (Debt Collection Report of 1981). Another vital purpose of performance standards would be to facilitate the research being done on government credit practices and procedures. As the McManis Report notes, credit reform "will necessarily require a modification of long-established agency credit policies and decision-making procedures and their effectiveness, some type of standard must be established." A performance standard has already been established in HHS, as noted below.

Since the majority of agency heads have the discretion to set credit standards, there seems to be no impediment to the establishment of performance standards (McManis Report).

Citations

HHS has a performance standard for participating schools in its Public Health Service program (42 USC § 294). Any school that has a delinquency rate higher than 5 percent on June 30 of any year will be required to:

> "...reduce its delinquency rate by 50 percent (or a school with a delinquency rate below 10 percent must reduce its rate to 5 percent) by the close of the following

> six-month period; and (2) by the end of each succeeding six-month period, reduce its delinquency rate to 50 percent of the required rate for the previous six-month period, until it reaches 5 percent."

42 CFR Part 57.216 a(c), p. 301. Borrower and delinquency rates are also defined in Part 57.216(b) and (e).

Solution

Performance standards could be established in all new programs legislated by Congress and in all existing programs regulated by agency.

The disincentives to the establishment of credit standards may account for their nonexistence. The establishment of loan loss estimates, for example, would result in a better understanding of the cost of some programs. Accordingly, program managers may fear a subsequent reduction in appropriations if their program does not perform well (McManis Report, p. 68).

Program managers and loan officers are often faced with pressure to make loans. In view of this, clear credit policies and performance standards, such as maximum default levels, would improve government credit management.

MATRIX OF STATUTORY AND REGULATORY IMPEDIMENTS TO OR SUPPORT FOR REPORT RECOMMENDATIONS

Agency	REA		CCC		EDUCATION		FmHA								HUD			FHA		
Program Direct Loan (D) or Guaranteed (G)	REA Loan	REA Guarantee	Price Support	Storage Facilities	NDSL	GSL	Business & Industry		Real Estate		Farm Operations		Rural Housing		Investor-Sponsor Coop	Group Practice Facilities Program	Mortgage Insurance Rural Housing	Title I Mobile Home Loan Insur.	Single Family Mortgage Insur.	Land Development & New Communities
Report Recommendations & Page References	D	G	D	D	D	G	D	G	D	G	D	G	D	G	G	G	G	G	G	G
Perform Credit Elsewhere Test											0									
Charge:																				
Application Fees	X	X					0	0	0	0										
Guarantee Fees		X						0		0					0		0	0		0
Origination Fees	X	X					0	0	0	0										
Change Interest Rates When Appropriate	X				X	X														
Avoid Interest Subsidy When Appropriate	X				X	X									0	0	0		0	
Lower Maximum Guarantee Level/Lender Participation Rate								X	0				0		0		0	0		0
Provide Sunset Provision																				
Establish Definition for "Delinquency"			0										0	0			0			
Set Uniform Action on Late Payments			0															0		
Allow Consistency in Loan Forgiveness					X	X														

X -- Statutory or Regulatory Impediment to Report's Recommendations

0 -- Statutory or Regulatory Authorization for Report's Recommendations

MATRIX OF STATUTORY AND REGULATORY IMPEDIMENTS TO OR SUPPORT FOR REPORT RECOMMENDATIONS

Agency	FHA							Transportation	Commerce		HHS							EX-IM	
Program Direct Loan (D) or Guaranteed (G)	Housing in Older Declining Areas	Homes for Low/ Moderate Income Famlilties	Homes in Urban Renewal Area	Subsidized & Public Hsng. Prgm.	Interest Reduction Program	Mtge. Insur. Premius & Fees Hms./Outlaying Ars.	Rehab. & Neighbor-hood Conser. Insur	Federal Ship Financing	Fishing Vessel Obligation Guarantee	Fisheries Loan Fund	National Health Service	Medical Facilities	Health Profes. Educ. Loan Payment	Nursing Student Loan	Health Research Teaching Facilities	Health Maintenance Organizations	Health Education Assistance Loans	EX-IM Loans	EX-IM Guarantee
Report Recommendations & Page References	G	G	G	G	G	G	G	G	G	D	D	D	G	D	G	G	G	D	G
Perform Credit Elsewhere Test	0			0		0				0								0	0
Charge:																			
Application Fees																			
Guarantee Fees		0	0		0	0		0	0		0								0
Origination Fees																			
Change Interest Rates When Appropriate																			
Avoid Interest Subsidy When Appropriate		0	0			0	0	0		0		0	0	0	0	0			
Lower Maximum Guarantee Level/Lender Participation Rate		0	0			0	0	0	0			X	X	X	0	0	0		
Provide Sunset Provision				0														0	0
Establish Definition for "Delinquency"						0		0											
Set Uniform Action on Late Payments										0	X			0			X		
Allow Consistency in Loan Forgiveness											X	0		0	0	0	0		

X -- Statutory or Regulatory Impediment to Report's Recommendations

0 -- Statutory or Regulatory Authorization for Report's Recommendations

MATRIX OF STATUTORY AND REGULATORY IMPEDIMENTS TO OR SUPPORT FOR REPORT RECOMMENDATIONS Page 3 of 3

Agency	SBA					DEPARTMENT OF ENERGY								
Program Direct Loan (D) or Guaranteed (G)	7A Business		State	Local Development	Bond Guarantees for Surety Co.	Pollution Control Financing Guaran.	Synthetic Fuels		Resovoir Confirmation	Coal Mine Loan Guarantees	Geothermal Loan Guarantees	Alternative Fuel Demo. Facilities	Alcohol Fuels	
Report Recommendations & Page References	D	G	D	D	G	G	D	G	D	G	G	G	D	G
Perform Credit Elsewhere Test	0	0	0	0	0		0	0	0	0	0	0	0	0
Charge:														
Application Fees														
Guarantee Fees		0		0	0	0		0		X^a	X^a	0	0	0
Origination Fees														
Change Interest Rates When Appropriate							0	0						
Avoid Interest Subsidy When Appropriate														
Lower Maximum Guarantee Level/Lender Participation Rate	X		X		X	X		X	X	0	0^b	0^b	0^b	0^b
Provide Sunset Provision							0	0						
Establish Definition for "Delinquency"	0	0							0					
Set Uniform Action on Late Payments									X					
Allow Consistency in Loan Forgiveness														

X -- Statutory or Regulatory Impediment to Report's Recommendations

0 -- Statutory or Regulatory Authorization for Report's Recommendations

(a) Limits Guarantee Fee to not More Than 1% of Outstanding Debt

(b) Based on Project Costs, not Loan Amount

STATEMENT OF

DWIGHT INK

for the

COMMITTEE ON GOVERNMENTAL AFFAIRS
UNITED STATES SENATE

ON
S. 2230

THE FEDERAL MANAGEMENT REORGANIZATION
AND COST CONTROL ACT OF 1986

JUNE 24, 1986

Mr. Chairman and Members of the Committee:

The leadership of the Senate Committee on Governmental Affairs and its staff should be congratulated on its initiative to revitalize federal management through the "Federal Management Reorganization and Cost Control Act of 1986." I appreciate the opportunity to provide comments which, I should stress, represent my personal views. These comments will be focused on the proposed Office of Federal Management.

As background for my statement, I should say that I had a unique opportunity to observe the effect of establishing OMB since I had responsibility for most of the management work in BOB before the changeover and held the same position in OMB after the change. As BOB Assistant Director for Executive Management, I had responsibility for fedral management at the time the Ash Council recommended strengthening the mangement role of BOB by replacing it with OMB. Under an agency leadership supportive of management we had been able to rebuild a far reaching management effort through which, among other things, occured the design and coordination of most of the successful New Federalism effort of the Nixon Administration. In cooperation with GAO, a government wide productivity program moved forward, major reorganizations were executed, and tremenduous strides were made in red tape cutting. In retrospect I belive that one key to the management improvement success of many departments and agencies was the fact that the major focus was on streamlining program management rather than concentrating on simply redesigning administrative processes. Another key was the extent to which initiatives were developed on the basis of how the impact of federal actions were perceived by people and communities throughout the nation rather than how they were perceived by Washington officials.Despite these successes, there was a constant struggle to maintain momentum and avoid being swallowed in the inexorable march of the yearly budget.

Establishment of OMB

Many of us welcomed the Ash Council proposal to put the "M" in BOB as a step which could help compensate for the pervasive preoccupation of BOB in the budget process. Except for brief intervals, management had been largely a stepchild after the initial strong initiatives of Don Stone when BOB was first established. Only in the reorganization area had BOB truly lived up to expectations and that was due largely to the great skill, knowledge, and resourcefulness of Harold Seidman and his staff who were effective in this area despite the budget activities being co-located in BOB, not because of it.

I was given responsibility for drafting the Reorganization Plan establishing OMB, and for managing its passage in Congress. After a very stong battle, we overcame strong House opposition and the Plan was permitted to go into effect.

Because of the high stature of the new OMB leadership, George Shultz and Casper Weinberger, and later, Frank Carlucci, OMB got off to a promising start. But as time progressed it became apparent that apart from those initial excellent appointments nothing had really changed. And when the strong momentum of the early 70s was slowed by Watergate, we were back to business as usual.

An admirable effort has been put forth by Joe Wright to rebuild management leadership in OMB through Reform 88, and some excellent actions have been taken, particularly with respect to financial systems. But I do not believe this program has been able to proceed much beyond administrative systems to where it effectively addresses program management which is where the major pay dirt lies. Even administrative systems tend to remain highly centralized and over regulated. Management initiatives throughout much of the federal government, in my judgement, remain too preoccupied with procedures. Placed in a different environment, I suspect that this positive effort would have been able to progress on an even broader front.

There are a number of factors unrelated to organizational location which make it surprisingly difficult to provide strong management leadership in the federal government. Nevertheless, location is extremely important if management attention is to compete with other important responsibilities of the public service.

It is widely recognized that an OMB Director is consumed with the crushing demands of budget and finance issues. Directors are extremely able people, but they function in a fiscal pressure cooker and have almost no time for management issues, even if they are so inclined, unless these issues are related to financial systems such as cash management and payroll systems. Little time is available to provide interagency leadership on streamlining federal program administration, speeding up federal decision making processes and delivery systems, or cleaning up accountability, despite the fact that tight budgets greatly increase the need for such actions. It seems to me we are devoting far more attention to multiple systems of reviewing and scrutinizing the actions of program managers than we devote to the better training and equipping of those managers so they can take sound actions in the first place.

We place both program and administrative managers within a forbidding web of formal and informal constraints, impose torturous procedures, add an enormous dose of Monday moring quarterbacking, and then wonder why our managers often do not move with the decisiveness associated with the private sector. This Catch-22 thrust has gained momentum over the years, and all signs point to its continuance.

The Myth of Budget Leverage:

For years conventional wisdom held that colocation with the budget provided the kind of leverage that was required for effective management leadership. On occasion that is true. Far more often it provides the wrong kind of leverage. At times it has constituted a barrier between the management component of OMB and the departments and agencies with whom they are to work.

The power base of OMB are the budget examiners, highly competent career professionals, and their political supervisors. They have much to say about the level of resources proposed by the President in whatever set of programs happen to be assigned to particular examiners. Control of funds carries great weight in influencing agency policies and priorities. Without this mechanism, in fact, modern presidents would face tremendous difficulties in developing and maintaining any coherence within the Executive Branch. The focus of this powerful leverage, however, is pointed along relatively narrow bands of program activity. The analyses of an examiner center on the process and the impact of one of these bands of activities and rarely, if ever, touches on the cumulative impact on people, on business, on state and local governments of the totality of federal activities and their attendent plethora of regulations. Neither communities nor businesses are fragmented or compartmentalized along the lines of the individual jurisdiction of the budget examiners.

Some years ago, governors, mayors, and neighborhood leaders throughout the nation were complaining bitterly about the red tape that was undermining much of the federal effort to assist states and communities through hundreds of categorical grants. The cumulative impact of the tens of thousands of federal requirements on these communities in terms of high costs and wrenching delays was not evident to the fragmented budget process and their operators which in many ways reinforced the red tape by striving to target particular groups and by encouraging complex limitations on how funds were to be spent. The capacity of our states and cities to govern was undercut, and the inner city disadvantaged became disillusioned by the long program delivery delays which stretched into many months and even years. Low income families became embittered by how much of the funds were eaten up by high overhead caused by the complicated administration of these grants.

Attacking this procedural morass in the early 1970s required a massive cooperative effort among BOB management staff, departmental assistant secretaries of administration and deputy secretaries, and seven nationwide state and local associations involving all the governors and thousands of local officials. Presidential support was strong. OMB management provided the leadership. After three years of effort, administration of most of the discretionary grants had been decentralized out of Washington, scores of thousands of administrative steps had been eliminated in over 400 federal programs, overhead costs greatly reduced, and processing time often cut 50% to 75%. State and local leadership across the nation applauded the changes, although some of the gains were later lost when the scope of the OMB management effort was curtailed. This management improvement was a true reform, one which had public visibility, one which made a difference to the people of the nation.

In the middle 70s, most of the management functions were transferred to GSA for roughly two years. Although I agree that federal management leadership should be placed in the Executive Office of the President rather than GSA or any other entity outside EOP, we were surprised to find that there were some management efforts, formerly blocked by a budget dominated OMB, that could begin to move forward after this transfer to GSA by virtue of having been freed from the budget linkage. Pilot studies of the amount of grant funds diverted into high overhead, rather than reaching the intended program targets, is one good example of management issues stalled until greater separation from the budget dominance took place.

Earlier, we encountered considerable resentment in DOD when, as BOB Assistant Director, I began exploring management initiatives with key DOD officials resulting in a DOD protest being lodged with the BOB director. When Secretary Laird learned, however, that the BOB management unit was truly separate from the budget operation and not a back door tool for the budgeteers, we were invited in. Upon Secretary Laird's completion of his tour, he sent a letter to the OMB director expressing deep appreciation for the help and cooperation of the management group in OMB. Our service in assisting the secretary improve his management was possible because of our independence from the budget process, not because of our reliance upon its proximity.

It is also my judgement that the budget role tends to move management in the direction of overregulation. I contrast the current detailed OMB review of each proposed agency regulation with the earlier New Federalism approach in which there was wholesale elimination of regulations in hundreds of federal programs. In the latter case OMB relied upon professional competence of the agencies and positive OMB leadership, rather than a centralized regulatory approach.

On several occasions under both BOB and OMB, efforts have been made to largely integrate budget and management groups through such devices as Management Associates. The scattering of useful actions resulting these integration efforts have been heavily outweighed by a wave of disasters in each instance. Essentially this integrated approach has helped the budget process, and at times financial management, but only at the expense of more basic program management which was either abandoned or undercut.

The tremendous OMB concentration on the annual budget is inevitable under existing conditions, a focus which distorts many management issues through overemphasis on a 12 month time frame. Budget examiners strive to look beyond the 12 month impact of changes, but the system makes this task difficult.

Other witnesses have listed a number of excellent points in support of our OFM, points I will not attempt to restate. In particular, I endorse the testimony of Messrs. Kline and Bingman. In conclusion, the theory of using the budget as leverage to attract and/or enforce stronger management is attractive, and there are a few instances when it has been useful. On the whole, however, experience has shown the close organizational proximity of management and budget to have serious negative consequences.

Therefore, although I agree that we must retain the government wide leadership role within the Executive Office of the President, I also believe we must reequip and strengthen it with important tools it has lost in recent years, particularly that of drafting and coordinating the issuance of Presidential orders and directives, and we should also free the management activities from the dominance of the budget. In short, I urge the adoption of the Office of Federal Management along the lines advocated by the 1983 National Academy of Administration Panel on Revitalization of Government.

0179d

Statement

By

Harold I. Steinberg

Partner

Peat, Marwick, Mitchell & Co.

On

S.2230

The Federal Management Reorganization and Cost Control Act of 1986

To The

Senate Committee on Governmental Affairs

My name is Harold I. Steinberg and I am a partner in the international accounting and management consulting firm of Peat, Marwick, Mitchell & Co. I am pleased to provide a statement on S.2230, the "Federal Management Reorganization and Cost Control Act of 1986." My views and suggestions result from a combination of two vantage points. The first is the experiences and insight obtained during almost three years as Associate Director for Management at the Office of Management and Budget, where I was responsible for initiating and coordinating Federal management activities. The second is the ten years I have spent as a management consultant working directly with the Federal employees who perform the management activities.

The "Federal Management Reorganization and Cost Control Act of 1986" is a landmark bill. It would establish many substantive programs to improve the use of management and other scarce resources. It has also set the legislative process into motion on a very critical issue, namely the management of the trillion-dollar enterprise known as the United States Government. An excellent 1983 General Accounting Office study, entitled "Selected Government-Wide Management Improvement Efforts - 1970 to 1980," verified that the management improvements that have endured in this government have resulted from legislation.

I will focus my remarks, however, on the portions of the Bill concerning financial management. Senator Roth, in his March 26, 1986, floor statement introducing the Bill, concentrated on the financial management weaknesses. I recognized the same weaknesses in an article I wrote for the Fall 1985 issue of the Government Accountants Journal in which I proposed a somewhat radical program for addressing the Federal Government's financial management problems. A copy of that article is attached.

THE UNDERLYING PRINCIPLES

I would like to start by pointing out that the Committee's proposal, a recently-introduced House bill containing the same objective, my Government Accountants Journal article, and several other proposals to improve financial management generally reflect four key principles. These are:

- Avoidance of Fragmentation - Improving and maintaining strong financial management requires strong leadership. It also requires that the responsibility for financial management not be divided among several organizations, i.e., the Office of Management and Budget, the General Accounting Office, the Department of the Treasury, and the departments and agencies, as it is now.

- Continuity - Improving and even maintaining the effectiveness of financial systems requires a consistency and continuity in direction, not the changes that occur with frequent changes in leadership.

- Sufficient Resources - Financial management, like any other important program, needs quality personnel, the latest technology, and the attention of senior officials.

- Attention to System Improvements - Efficient and effective system improvements require sound standards, thorough planning, and appropriate integration with other systems.

The challenge, therefore, is to provide for adherence to the four underlying principles. That, in turn, will enable the improved financial management objective, as set forth in the various proposals, to be achieved. However, the transformation must be done incrementally, since that is the key to obtaining change in a government.

In my opinion, the best way to proceed is to consider that the solution has two parts. The first part is the definition of the functions, responsibilities, and authorities for a position in the Government that would be responsible for financial management. The second part is establishing the two key structural aspects of the position. They are 1) the overall role of the position, i.e., whether it should be a line position or a staff position; and 2) where the position should be located, e.g., at Treasury, at the Office of Management and Budget, in the Executive Office of the President but not the Office of Management and Budget, or elsewhere.

There is evidently widespread agreement on the functions, responsibilities, and authorities needed to provide strong, non-fragmented, and continuing leadership, secure sufficient resources, and maintain efficient, and effective financial systems. I could offer the following and, while polishing is always appropriate, they could probably be enacted into law without major disagreements from those who want strong financial management for the Federal Government.

- o Provide leadership, direction, guidance, and monitoring of the Government's financial management systems. This establishes the incumbent as the Chief Financial Officer for the Federal Government and expresses the basic charter for the function.

- Advise the President, the Congress, and agency heads on financial management matters and the status of financial management in the Federal Government. This responsibility reflects the importance of the financial management function and ensures that its status is brought to the attention of those responsible for the overall management of the Government.

- Work with the Secretary of the Treasury in identifying and fulfilling the system and reporting needs that will enable the Secretary to report financial position and results to the President and his senior advisors, the Congress, and the public. This ensures that the Secretary of the Treasury has the information with which he can fulfill his role as financial advisor to the President and the Congress.

- Establish policies describing the objectives, structure, and information requirements for government-wide and agency-based financial management systems. The responsibility and authority to establish policies will enable the Chief Financial Officer to specify for the agencies what should be accomplished and what should be done to obtain the desired accomplishments. It would also enable him to inform non-financial managers as to what they can expect from the financial management function.

- Prescribe policies and procedures for the design and implementation of government-wide and agency-based financial management systems. This would enable the Chief Financial Officer to direct the performance of the financial management function. The most significant benefit would be a reduction, and hopefully an elimination, of the thousands of costly instances where integration is lacking among and between different systems, and particularly the systems of different organizations.

- Prescribe policies and procedures for agency financial operations including, but not limited to, asset management, cash mangement, credit management, debt collection, inventory management, and property management. The manner in which agencies approach financial management can have a significant impact on the resources required to run the Government. This responsibility and authority ensures that the agencies will devote sufficient attention to financial management.

- Participate in the formulation of the financial accounting principles and standards with which the Federal Government and its agencies report their financial position and results. The Chief Financial Officer, who will probably have the best understanding of the cost-usefulness of the Federal Government's financial information, should be a key participant in the formulation of the principles and standards that define the financial information that should be reported.

- Prescribe policies and procedures for government-wide and agency-based financial reporting in accordance with appropriately established financial accounting principles and standards. Since principles and standards provide only broad directions, it is necessary to have policies and procedures to specify how the principles and standards are to be met.

- Develop and maintain directives and materials necessary to obtain and maintain integrated, standardized systems. The achievement and continuing existence of efficient and effective financial management systems require the formulation and promulgation of support materials. Examples are a standard chart of accounts structure and system interface conventions.

- Develop long-range plans for improving and maintaining the financial management function in the Federal Government. This responsibility will ensure that the tasks necessary to implement and operate this complex activity will have been well thought out, the required resources will have been identified, and the intentions properly communicated to the appropriate organizations and persons.

- Review agency financial management plans and policies in order to ensure such plans and policies are consistent with the overall policy objectives, structure, and information requirements. Planning at the agency level serves the same function as at the government-wide level. It is important that the plans be consistent with the government-wide plans and programs.

- Review agency budget requests for financial management and advise the President, the Director of the Office of Management and Budget, the agency heads, and the Congress on the financial resources required to effectively operate and maintain the agencies' financial management systems and correct any major deficiencies in such systems. Effective financial management systems need resources. This responsibility and authority is intended to assure that an agency is not short of the required resources.

- Monitor the activities of the agencies' financial management function to ensure that adequate financial management systems have been established and are operating effectively and such systems meet the needs of agency managers for financial information. With all the policies, directives, and resources in place, it is still necessary to oversee the operation and ensure it is functioning as intended and that the agency and program managers' needs are served.

- Review the development and enhancement of agency financial management systems in order to assure that the development and enhancement of such systems comply with approved agency financial management plans and are effectively carried out. The substantial monies being provided to improve, in contrast to operate, systems require a careful monitoring of the development efforts to assure that the agency is receiving what it intended to receive.

- Monitor the application of the prescribed financial reporting policies. A Chief Financial Officer is always responsible for assuring that reported financial information is in accordance with prescribed principles and policies. This is particularly important in the absence of an independent financial audit.

- Facilitate the exchange of information between agencies on financial management systems and efforts to improve such systems. A mechanism that enables agencies to benefit from the experiences of others is always helpful. Such a mechanism functions best when the responsibility for its operation is clearly defined.

- Encourage and coordinate interagency projects to design and implement integrated, standardized systems in order to reduce the number of systems, eliminate duplication, foster parity and consistency, and improve efficiency. The lack of integration and standardization among agency financial systems is one of the major financial management problems. It results in excessive, unnecessary costs and impairs the reliability and timeliness of financial information. A Chief Financial Officer must have the ability to improve interagency coordination.

- Provide advice to agency heads with respect to the selection of agency controllers. This responsibility and authority can be useful for improving the quality of agency controllers. It will also increase the likelihood of substantial interagency coordination.

- Provide technical assistance and training, as appropriate, to agency controllers on matters relating to financial management. A small training and technical assistance capacity can enable the Chief Financial Officer to provide agency controllers with a working familiarity with significant developments.

- Ensure that independent financial audits are periodically performed on agency financial statements. Financial audits can provide an independent assessment of the reliability of the financial systems and information. In fact, comprehensive and frequent financial audits can stimulate the improvement of the financial management systems.

- Provide guidance to the Director of the Office of Personnel Management in the development and implementation of personnel qualifications and job descriptions for financial management positions and for professional development and training programs. With personnel key to the success of financial management, it is imperative that the Chief Financial Officer be able to influence the policies and programs that affect the quality of financial management personnel.

THE STRUCTURAL ISSUES

A good way to address the structural role and location issues is to use a decision analysis tree. I have prepared and attached one to this statement. Using the tree, a proposed solution can be reached in the following manner.

Line or Staff Function?

The first issue is whether the Chief Financial Officer (CFO) should be a line function, responsible for operating the Federal Government's financial systems and accumulating and reporting financial information; or whether it should be a staff function with numerous responsibilities and authorities, but not including operating the systems and accumulating and reporting the information.

Analysis would reveal that in many ways there already is a line Chief Financial Officer in the Secretary of the Treasury (or at least his subordinate, the Department of the Treasury's Fiscal Assistant Secretary). Assuming the purpose of legislation is to institute change, choosing the line approach would require a change that provides the Secretary of the Treasury/Fiscal Assistant Secretary with more line authority.

The next increment in authority would be for the department and agency controllers to be part of the CFO's line organization, rather than part of the departments and agencies for which they provide financial management. Westinghouse, ITT, and other successful major corporations use this approach. While I proposed this approach in my Government Accountants Journal article, it should be realized that transferring the department and agency controllers to an organization to be headed by the Government's Chief Financial Officer would be a very substantial change. Many would perceive it as removing power from the department agency heads. The department agency controllers would believe they have a dual reporting responsibility. Thus this approach would probably be difficult to enact.

The alternative, which is creating the Chief Financial Officer as a staff function, could be accomplished with minimal organizational change. In fact, since it can be achieved quicker and more easily than the first alternative, a staff role may well be preferable -- provided it has the focus necessary to provide leadership. Endowing the function with the previously described responsibilities and authorities gives it, even in the staff mode, all the focus it needs.

Location of the Function -- Treasury or OMB?

Assuming a decision to obtain the needed focus for the Chief Financial Officer by establishing a staff function, the next question is where to place the function. The two obvious alternatives are the Department of the Treasury, which already performs numerous financial management activities; or within the Executive Office of the President, which, for all practical purposes, is the staff to the President. (A third alternative, the General Accounting Office, is eliminated because it is not part of the Executive Branch.)

Most people believe that Treasury does not have the stature, access, or authority to serve as an effective staff-level Chief Financial Officer. Indeed, while Treasury already has several of the suggested responsibilities and authorities, since it does not have line authority over the agencies' financial managers, it has had difficulty carrying them out. In other words, Treasury could perhaps be a logical place for a line CFO, but not for a staff CFO. Also, I suspect OMB would raise strong objections with the removal of certain authorities from OMB to the Department of the Treasury.

The alternative, as stated, is placing the Chief Financial Officer in the Executive Office of the President (EOP). This would provide him or her with the additional stature, access, and authority that can be so helpful for obtaining adherence to policies and directives. It would also eliminate, at least in part, OMB's concern with the removal of certain authorities and responsibilities. For these reasons, I support placing the Chief Financial Officer as a staff position in the Executive Office of the President.

OMB Or EOP But Outside OMB?

The next question is whether the function should be within OMB (which is part of EOP) or outside OMB, but still within EOP. If it is placed outside OMB, the proposal will still draw OMB's resistance to the removal of important management responsibilities and authorities. Furthermore, the opportunities to coordinate financial management with budget allocation and other management functions will be significantly lessened. This is not an insignificant drawback. Affiliation with the organization that approves the agencies' budgets provides substantial leverage which cannot be replaced easily. Finally, making the CFO a separate unit within the EOP would result in an undesirable expansion of the number of activities under the direct purview of the President.

These arguments have merit. Furthermore, the only argument raised against placing the function in OMB is that OMB is not likely to give it the necessary attention. However, this objection can be solved in other ways, which I shall explain shortly. Hence, I suggest that the best place for a Chief Financial Officer staff function is in OMB.

Assuring the Importance of the Function in OMB

As indicated in the prior paragraph, the next issue in the decision analysis is how to assure that if the function is placed in OMB, its significance and importance would be adequately recognized. Again, two alternatives appear feasible: 1) making the CFO part of an enhanced management function, or 2) establishing the CFO as a separately constituted function within OMB but with unique perogatives.

The most frequently mentioned enhanced management function approach is to establish two deputy directors at OMB -- one for budget and one for management. The CFO would be a unit under the Deputy Director for Management. The disadvantage to this approach is that it would dilute the attention needed for what is currently a very substantial problem. In fact, the new function is not likely to be perceived or executed as a substantive change. Finally, there is the problem of having to secure political and other support for addressing other functions by aligning them with the management side, even though many would not be considered management functions or even "broken."

Other approaches to enhancing the management function may also be possible but I suggest the best approach, and indeed the ultimate solution to the location issue, is to establish the Chief Financial Officer as a separately constituted function within OMB. This should be the easiest to achieve legislatively; it provides the focus for addressing one of the most significant management problems; and it can provide the necessary status for the financial management function. Furthermore, there are precedents with a separately constituted function within OMB, namely the Office of Federal Procurement Policy and the Office of Information and Regulatory Affairs.

Therefore, I am proposing that legislation be enacted establishing an Office of Financial Management within OMB. The Office should be assigned the functions, responsibilities, and authorities presented earlier in my statement, or some variation thereof. The legislation should provide that the Office of Financial Management should be headed by a Presidentially-appointed/Senate-confirmed Chief Financial Officer who is selected without regard to political affiliation based upon demonstrated ability and experience in financial management, financial systems development and operation, accounting, and financial analysis, and who can be removed by the President, provided the President communicates the reasons for the removal to the Congress.

These personnel provisions are patterned after what exists in the Inspectors General Act to reflect the fact that the financial management function is not a political function. They would also satisfy the concerns of those that believe the Chief Financial Officer position should have a tenure that extends beyond a President's term, but does so in a way that would be politically and legally acceptable.

I also recommend that the legislation authorize a separate budget appropriation for the Office of Financial Management, in the same manner a separate appropriation is authorized for the Office of Information and Regulatory Affairs. This should help assure that the resources Congress and the President intend to expend for financial management are indeed spent on financial management.

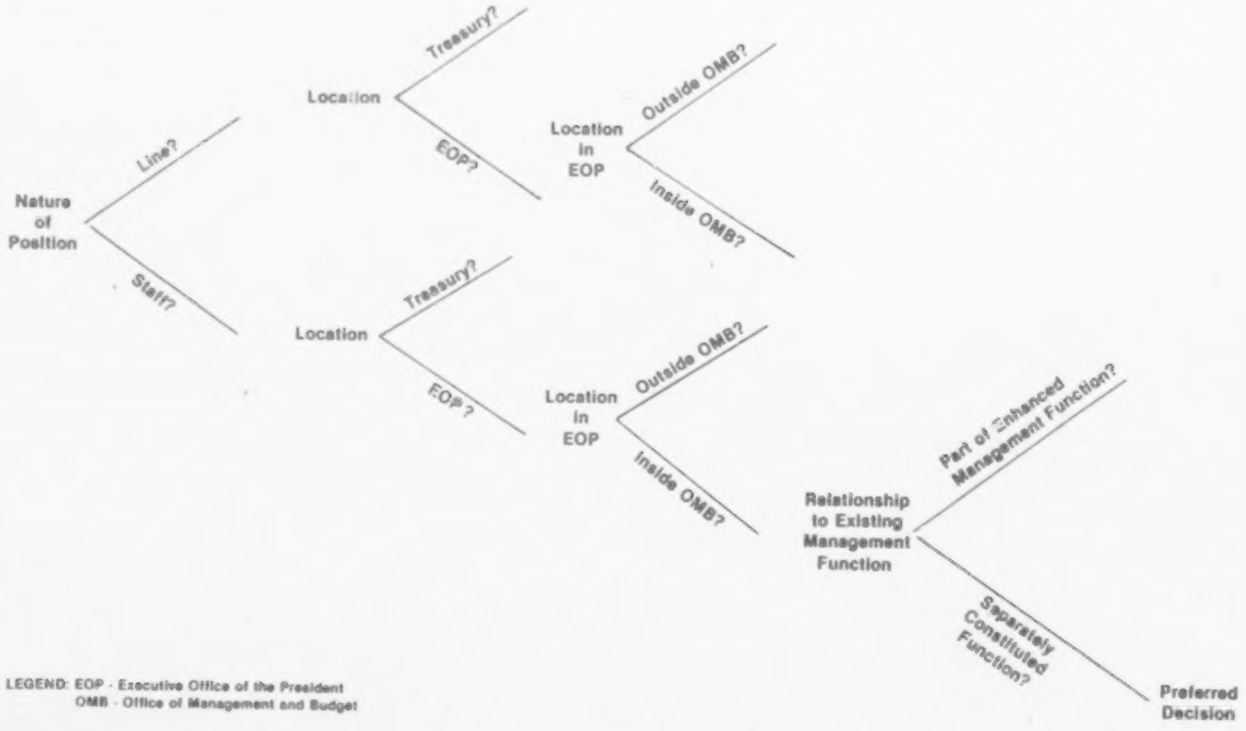
CONCLUSION

In conclusion, I support the effort to improve the management of the Government, but I would hope the major attention is devoted at this time to improving financial management. Financial management has some of the biggest problems, it is a function that can be addressed in and of itself, and there is considerable support for addressing financial management even if the other types of management are not.

I believe the approach I have presented provides the needed focus and authority. I believe it satisfies the objections that would be expressed with the more sweeping proposals. Most important, I believe it can achieve the most significant goal of meaningful, lasting reform. I would be pleased to provide support and input for the Committee's pursuit of this same goal.

DECISION ANALYSIS TREE

STRUCTURAL ISSUES FOR A CHIEF FINANCIAL OFFICER FOR THE FEDERAL GOVERNMENT


Nature of Position
Line?
Staff?
Location
Treasury?
EOP?
Location
Treasury?
EOP ?
Location in EOP
Outside OMB?
Inside OMB?
Location in EOP
Outside OMB?
Inside OMB?
Relationship to Existing Management Function
Part of Enhanced Management Function?
Separately Constituted Function?
Preferred Decision

LEGEND: EOP - Executive Office of the President
OMB - Office of Management and Budget

The GOVERNMENT ACCOUNTANTS JOURNAL

Reprint

Improving the Federal Government's Financial Management

FINANCIAL MANAGEMENT IN THE PUBLIC SECTOR

Published by
The Association of Government Accountants

FALL 1985
Vol. XXXIV, Number 3

Improving the Federal Government's Financial Management

Harold I. Steinberg

The Federal Government's financial management practices have been receiving considerable exposure in the public and professional media. Most of the publicity has been about the problems, or more accurately the effects of the problems, such as managers' inability to obtain timely financial information; antiquated and inefficient financial processing systems; difficulties in collecting loans; the unexpected high costs of purchased goods. The litany goes on and on.

Less has been said about how to correct the problems—and that which has, addresses only pieces. Yet a need so immense and so complex requires a solution that addresses all aspects of the problem and that is sensitive to the unique needs of the government. Drawing upon the insights obtained during three years in Federal Government management, I suggest in this article an approach for addressing the much heralded financial management problems.

The Current Situation

In actuality, a recitation of the Federal Government's financial management problems need not be avoided. It stimulates the concern with seeking improvements. It provides the understanding necessary for developing a program for improvement.

Thus, it is interesting to note that the three organizations that have voiced the most concern with the current financial management deficiencies appear to agree on the problems. The three organizations are the Office of Management and Budget (OMB), in its role as spokesperson for the President's Management Improvement Program: Reform 88; the General Accounting Office (GAO); and the President's Private Sector Survey on Cost Control, better known as PPSSCC or the Grace Commission. Indeed, the three organizations differ only on the importance they attach to certain aspects of the problems in relation to others.

A review of documents released by the three organizations, supplemented by the views of people familiar with financial management in the Federal Government, results in the following summary of major shortcomings:

- The responsibilities and authorities for establishing financial management policies, monitoring their execution, and reporting the results are divided among the GAO, OMB, and the Department of the Treasury. Moreover, the actual financial management processes are performed at, and the resources necessary to undertake the work are distributed to, the agency level where they fall under the authority and responsibility of the heads of the agencies. Agency heads, however, generally have little time for or interest in financial management matters. Their primary interests—and rightfully so—are with the agencies' programs.

As a result, financial management is frequently treated as a stepchild at the level at which it should operate best, i.e., the agency level. Resources are directed first to program and policy needs; financial management personnel generally do not receive the personal satisfaction associated with senior level attention and challenges; and the most promising individuals leave for more rewarding positions.

- Another result of this dispersal of financial management operations to the individual agencies is that each agency has been free to establish its own financial management approach and systems. This has meant a different system in each agency, and even in separate, but similar, components of the same agency, e.g., the research laboratories operated by the Navy Department. Furthermore, this situation exists not just for the systems that operate to serve an agency's program needs, e.g., debt collection, grants management, equipment acquisition. It also exists with the basic administrative systems, such as expenditure control, payment processing, and general ledger accounting. Consequently, systems development has been duplicative and vastly more costly and time consuming than necessary. The upgrades needed to handle changing requirements are equally difficult, time consuming, and costly to accomplish.
- Even with these supposedly tailored systems, the agency managers responsible for collecting, expending, and safeguarding literally billions of dollars do not obtain timely, reliable, or relevant information useful for monitoring and controlling their programs. Furthermore, since many do not have extensive managerial skills or experience, they do not appreciate the importance of data to managing complex programs. They frequently are not concerned that they do not obtain the information and they often would not, or could not, use the information effectively if they did obtain it.
- Compliance with the prescribed financial management principles, standards, and policies is uneven. The few mechanisms for obtaining compliance have not been effective.
- Last, yet making the need for effective efficient financial management so vitally important, is the fantastic size of Federal programs; the complex laws and policies under which they operate, most of which take effect without regard to whether the appropriate financial management systems are in place; and the general failure to provide adequate resources to fund the programs' financial management needs.

OMB, GAO, and PPSSCC all believe there is a solution to the problem. However, their solutions are different. OMB believes that through the budget review process, the importance of financial management information and systems can be elevated within each agency. It also believes that through a new OMB circular, the agencies will undertake numerous initiatives to upgrade their systems in a manner that will result in single, shared, and/or standard systems wherever practicable. GAO, expressing the auditor's viewpoint, believes the problem can be solved through each agency publishing, for external consumption, financial statements prepared in accordance with clearly defined, widely accepted accounting principles and then using the independent audit

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process to verify the systems and information from which the statements have been prepared. PPSSCC, perhaps reflecting the private sector's fascination with logic and orderliness, has proposed an organizational approach: establishing an Office of Financial Management, within an Office of Federal Management, which is part of the Executive Office of the President. It would provide the direction, coordination, and administration of the financial management function throughout the government. A variation of this approach has been advanced by the Association of Government Accountants in a recently released report. It recommends the legislative establishment of a Chief Financial Officer.

Each of these approaches has merit. Indeed, each has already stimulated sporadic improvements. However, these individual accomplishments do not come close to the magnitude of change necessary for the Federal Government to have effective financial management.

As a start, there must be a blending of the fundamentals of each group's approaches. The Federal Government needs to devote the attention to planning, organization, and people that typically exists in the private sector. At the same time, any improvement program must recognize the role of politics in the public sector. It also must not violate the constitutional doctrine of separation of powers among three branches of government.

In short, improving the Federal Government's financial management may be a monumental task requiring a monumental solution.

The Organizational Needs

Thirty years ago, the Federal Government's financial management was markedly better than financial management in the states. That is no longer the case. Many of the larger states (and cities) have state-of-the-art accounting systems that process data and produce information for their entire government; departmental managers obtain information instantaneously regarding the status of their assets, liabilities, and spending authorities; and the information is published periodically in financial statements that conform to generally accepted accounting principles and for which an independent auditor provides an opinion.

The General Accounting Office recently studied this reversal, hoping to determine the changes the states made to achieve these accomplishments. The GAO found four elements present in each successful state.

- The state devoted considerable time and effort to developing a comprehensive, detailed plan for obtaining improved financial management.
- The state expended considerable resources installing a computerized accounting system based, usually, on a system that already successfully operates elsewhere.
- The state determined the logical entity for which there should be financial statements and then prepared statements for that entity.
- The state obtained a financial audit from an audit organization that had sufficient knowledge of state and local government accounting principles and sufficient experience with financial auditing practices to perform a meaningful audit within a reasonable time.

However, there was a fifth change thirty years ago. It was made by the Federal Government, not by the states. Specifically, the Budget and Accounting Procedures Act of 1950 took a heretofore highly centralized accounting operation in the Federal Government, residing in the GAO, and distributed part of that operation to OMB, part to the Treasury, part to the agencies, and retained a part for GAO.

Hence, another reason the Federal Government fell behind in financial management was that there was no longer a single force—as most states have always had—possessing the ultimate responsibility for effective financial management in the government. Absent that central force to promote good financial management and bring it all together, there was no means to ensure that financial management was given proper attention in the agencies. The agencies' financial managers were off by themselves.

I suggest, therefore, that the first step is to rectify the change made thirty years ago and again have *one* organization responsible for the oversight *and* performance of financial management. More specifically, Congress should define the activities which would enable one organization to do the measuring, analyzing, and interpreting of the financial effects of personnel, facilities, equipment, financial, and program decisions, historically and prospectively, throughout government. This organization would then have timely, reliable, and relevant financial information for its own use and which could be made available to others, i.e., program and agency managers, who might need it.

As stated, this is not a new notion; others are suggesting again moving toward centralizing the financial management function. However, it is necessary to define what that means in terms of responsibilities, authorities, and organizational placement. Only then can elected officials decide whether the notion is appropriate for their support, and appointed and career officials have sufficient direction for proceeding.

Responsibilities of a Centralized Financial Management Function

Several sources are available to guide the definition of a centralized financial management function in the Federal Government. For instance, PPSSCC suggested that its recommended Office of Financial Management should be responsible for (1) advising the President and department heads on financial matters; (2) assisting department heads to institute sound internal controls and comply with GAO accounting and reporting standards; (3) coordinating the accounting activities of department comptrollers; and (4) performing the central government accounting and reporting functions.

Large state governments can also provide the model. For example, the financial management manual developed by the Commonwealth of Virginia's Comptroller for agencies and selected institutions lists the following responsibilities:

1. Provide senior management . . . . a regularly scheduled flow of information concerning financial conditions . . . .
2. Propose and participate in the formulation of agencies' fiscal policies.
3. Provide for the design, development, implementation, and maintenance of effective systems of internal accounting control . . . .
4. Provide annually a set of financial statements, disclosing the financial conditions . . . .

Perhaps the most comprehensive list of the responsibilities of a large governmental centralized financial management function appears in Management Directive 305.3 Amended, issued by the Commonwealth of Pennsylvania Governor's Office. Pennsylvania already has a centralized financial management function, directed by the Deputy Secretary for Controller Operations. The directive lists such responsibilities as:

- Overseeing the agencies' chief financial officers/comptrollers.
- Determining the goals for agency comptrollerships and evaluating their efforts and results.
- Establishing and improving internal fiscal and administrative policies.
- Providing central systems.
- Establishing standards for agency systems.
- Providing technical assistance for development of agency systems.
- Providing training to agency comptrollers.

A meaningful centralized financial management function for the Federal Government would need to have all of the responsibilities referred to above.

Authorities of a Centralized Financial Management Function

The more ticklish element in the establishment of a centralized financial management function is the authority granted to the position. Presently, each operating agency has its own controller who reports directly, or through a higher level position, to the head of the agency. Since most departments are composed of several agencies, there is often a person at the departmental level with a title such as Director of Financial Management. Typically, this is a staff position. The incumbent has little or no line authority.

As indicated, agency controllers reporting to agency heads is one of the major reasons for poor financial management. An agency head, for the most part, is concerned almost totally with the agency's programs. He or she generally does not provide sufficient guidance or resources to the agency controller. Nor does the agency head usually have much interest in financial management. Hence, it is hard for the controller to develop adequate systems, or even interest in the information the systems provide.

To rectify this situation, I suggest that serious attention be given to having the centralized financial management function also responsible for measuring, analyzing, and interpreting the financial effect of personnel, facilities, equipment, financial, and program decisions, historically and prospectively, *in the agencies;* and to do so through agency controllers who would be placed in their position by the centralized financial management function and then *report organization-*

ally to the centralized financial management function.

Moreover, the centralized financial management function would take the total resources the President and Congress allocate to financial management and use them to insure that each agency is provided with an efficient, effective financial management system (and information) that, to the maximum extent possible, is coordinated with the government's overall systems and the systems operated by other agencies. It would provide direction, training, and technical assistance to the agency controllers in order that they can remain proficient and challenged in their jobs.

There are two major, and possibly several minor, arguments against having the financial management function provided by a central source. The first is that financial management processing and information is a resource and the agency heads should decide how all resources should be used within their agencies. The second argument is that agency officials reporting to someone other than the agency heads may not be responsive to the agency heads' desires and directions.

As to the first argument, the agencies' primary mission is to provide services *to the public*. Since financial management is, in contrast, a service *to the agency*, agency heads should not have their attention diverted by the mechanics involved in obtaining financial management services. Indeed, in many ways these services are similar to the procurement services and building services traditionally provided to an agency by the General Services Administration, or the personnel services provided by the Office of Personnel Management. Furthermore, agency heads have demonstrated repeatedly that they do not provide sufficient resources for the financial management function, and thus the function and the agency suffer.

The response to the second argument is that a controller's information processing and measuring tasks are straightforward tasks for which the best responsiveness is reliable, timely service; and his information analysis and interpreting tasks should always be done in a neutral manner, regardless of for whom they are performed. Indeed, in financial management, a misdirected responsiveness to an agency head might prevent the disclosure of information which should be widely disseminated.

An exception would be budget preparation which, in government, is a policy, program, and political function, rather than the "number crunching" it often is in a business organization. The solution is to not include budget preparation in the centralized financial management function. It should remain a separate agency-based function, responsible to the agency head. It would, however, obtain the financial data needed to develop and control the budget from the financial data base maintained by the agency controller. This sharing of a common data base is already practiced in several large states.

Indeed, this separation could further strengthen the controllership function. Currently, financial data has little or no role in the development of the budget, which probably is why senior managers generally pay little attention to the financial management function. An independent controller, however, could calculate the financial effect of budget decisions and advise the program managers and agency heads of the reasonableness of the projected financial results, without fearing reprisals if his information does not support the program managers'/agency heads' desires.

Placement of the Centralized Financial Management Function

Placement of the centralized financial management function can also be a nettlesome issue, primarily because of the turf implications and the possible political backlash.

The PPSSCC recommended that the financial management function be placed in an Office of Federal Management that is part of the Executive Office of the President. There is a drawback to this approach. The effectiveness of the Executive Office of the President is maintained by limiting the Office's role to providing advice to the President and by having it assume an operational role only for specific, usually narrow, issues of a limited duration. The financial management function is an operating function. If undertaken by the EOP, the latter's overall effectiveness will be diminished. Equally important, performing the financial management function, as described in the responsibilities and authorities sections above, probably would require thousands of persons. Regardless of the reason for the action, it would be political folly for an incumbent President to be a party to a reorganization that adds that many persons to his personnel staff.

The GAO should also be ruled out as the home for the centralized financial management function. While the GAO has some financial management roles remaining from the pre-1950 era, as well as those specified in the Budget and Accounting Procedures Act of 1950, its major function is to serve as the external auditor of the Executive branch. The role of external auditor is incompatable with operating the financial management function.

The National Academy of Public Administration, in its 1983 report entitled *Revitalizing Federal Management: Managers and Their Overburdened Systems*, suggested the establishment of a separate organization to provide centralized financial management. The objection to this approach is that it would result in an additional unit involved in financial management reporting to the President. Also, as recommended by NAPA, this unit would not assume many of the responsibilities currently filled by Treasury, GAO, or the agencies. Thus the difficulties in obtaining coordination would continue.

The logical spot for the centralized financial management function is the Department of the Treasury. The Department already has a major share of the function; it receives and disburses the government's funds, accounts for these funds, and prepares financial statements that disclose the government's financial position and results. The Treasury has the ability to marshall the resources necessary to fulfill a centralized financial management role. It is already providing some central guidance through its Treasury Financial Manual (TFM), which establishes policies and rules for agencies to follow in the areas of central accounting and reporting, payrolls, deductions, and withholdings, disbursing and deposit of public monies, and other fiscal matters.

The key ingredient is for Treasury to accept, in mind and in deed, the mantle of chief financial officer for the Federal Government. In other words, it would need to recognize that along with its responsibilities for establishing and implementing tax policy and economic policy, like any corporate chief financial officer, it is also responsible for processing, controlling, and accounting for financial transactions and resources, and collecting, classifying, analyzing, reporting, and interpreting data for financial decision making and in support of the government's mission.

There is evidence that, despite the absence of full agreement among the key organizations or clear-cut instructions to proceed, the Financial Management Service, a unit of the Department, is already moving in that direction. It is developing an integrated, automated central financial management system to replace the present outmoded central accounting and reporting system; modernizing the Treasury's regional financial centers' systems to serve as the basis for a governmentwide financial information network; and establishing a financial policy division to develop and promulgate governmentwide policies to assure the integrity of the government's financial reports and processes.

Personnel

Assuming the Executive and Congressional branches are willing to modify the organizational approach to financial management, the next step would be to address the personnel needs. The inadequate attention devoted to the financial management function during the last thirty years has caused many good financial management personnel to leave the government. Worse yet, it has been difficult to attract individuals who have acquired extensive financial management experience in organizations other than the Federal Government to join the government. This causes significant inbreeding and a lack of new ideas and approaches to Federal financial management.

The traditional recommendation to correct this deficiency has been for a revamping of the personnel classification system and hiring process. Allegedly, modifications to the classifications would enable the agencies to be more precise in defining the skills needed to fill entry-level financial management positions, plus offer salaries that are commensurate with what the desired individuals could earn elsewhere. Simplifying the hiring regulations and reducing the accompanying paperwork would enable the agencies to get the desired people on board quicker.

The problem with this recommendation is that it is not easily obtained. The claim that a job cannot be performed as it should unless there is a relaxation of the personnel hiring restriction is made for many positions, not just the financial management positions. The result is that personnel regulations change very slowly. More importantly, as stated earlier, being able to hire the right people is not the problem; the problem is that the better people do not have a strong motivation to stay.

The PPSSCC inferred that tenure for financial managers, similar to the 15 year term and salary for life granted the Comptroller General, is needed to encourage qualified financial management personnel, particularly from organizations other than the government, to accept positions. The Comptroller General's need for tenure results from the fact that he is expected to critique programs and performance, and tenure removes inhibitions he might otherwise have. Financial managers are not critics or auditors; they do not need tenure to protect their jobs.

In reality, there are two other concerns far more significant to attracting and retaining qualified financial managers. First, organizations such as those that provided personnel for the short-term PPSSCC effort need to encourage their financial managers to look at a financial management position in government for a period of, say four to five years, as a challenging, important assignment which can provide an intense, valuable experience. These organizations can provide encouragement in many ways: advising financial managers during periodic performance appraisal and counseling sessions that a position in a government agency is useful for their careers; encouraging bright, promising financial managers to accept a financial management position when offered by a government agency; widely publicizing within the organization, in a positive way, persons who have taken a government position; and intelligently placing and making use of the skills and experience of financial managers who join the organization from the government.

Second, the commitment as to length of service must be obtained from the individual, not the government—and that commitment should be for four to five years. The differences between the governmental and non-governmental working environment, and the time necessary to learn to operate efficiently in the former, makes it virtually impossible to make a worthwhile and lasting contribution in a lesser time.

In the final analysis, however, the only way a sufficient number of qualified personnel will be attracted to *and* retained in the Federal Government financial management function is to make it interesting, challenging, and meaningful. That can be assured best by restructuring the function so that financial managers in each department and agency are part of a centralized financial management team charged with initiating and maintaining a financial management function in the government and each agency.

Thus, the centralized financial management function is appropriate not only in and of itself. It is perhaps the only way the government will be able to attract and retain the qualified financial management personnel needed to monitor adequately the use of financial resources and provide the necessary financial information.

Policies

Once the organization is defined and the ability to obtain and retain qualified personnel is in place, the next step is to establish financial management policies—governmentwide. Specifically, the centralized financial management function should promulgate to the financial management personnel in the agencies, in general terms, what should be accomplished and what should be done to attain the desired accomplishments. These policies would provide the guidance and direction for both the oversight and performance of the financial management function. The policies would also enable the agencies' non-financial managers to know what to expect from the financial management function.

Much of the policy has already been defined in OMB circulars and bulletins and Department of the Treasury manuals and regulations. OMB, in its recently issued *Financial Management and Accounting Objectives*, defined what is expected of an agency's financial management and accounting systems. Other OMB circulars, such as Circular A-125, and Treasury regulations, specify such things as when and how information is to be forwarded to Treasury in order that invoices can be paid. Some of these policies, however, could benefit from modification.

The first priority should be to develop and promulgate the policies for systems and management information needs. In many instances, the information the agencies have to control their assets, e.g., cash, receivables, facilities, inventories, is incomplete and/or unreliable. Also the systems providing the information are inefficient. These are probably the main reasons why agencies fail to effectively manage their assets. Hence, policies should be promulgated defining the types of information to be made available for each type of asset, the significance of that information to the agencies, and the actions managers should take based on the information.

Another high priority should be for policies that 1) require agencies to follow a prescribed systems development methodology and 2) enable the centralized financial management function to review periodically new systems development efforts. These would help ensure that new systems will be developed within a reasonable time frame and with a minimum possibility of failure. There should also be policies requiring the systems to have the internal controls, systems controls, and auditability and quality assurance characteristics that prevent and detect unauthorized losses.

A third category of useful policies would address the kinds of information that should be aggregated for and presented to the Congress and the agencies' senior managers. In developing these policies, it should be recognized that many political appointees in management positions do not want or will not use financial information—at least not by itself. His or her attention has to be secured with performance, economic, or other statistical information.

For instance, a report that simply discloses increased loan delinquencies would probably not interest the typical political appointee. He would, however, be greatly interested in seeing how much the agency's ability to make new loans has been reduced as a result of the increased delinquencies. The General Accounting Office has already started to address this need with its publication of two documents entitled *Managing the Cost of Government: Building an Effective Financial Management Structure*.

Accounting Systems

The next step to address in the financial management improvement process is the financial management systems. This entails developing systems where none exist and yet information is needed, updating or replacing old systems that are too reliant on outdated technology or too expensive to maintain, and integrating systems in order to simplify the processing and recording functions.

Since the scope of this article is broader than an analysis of the systems deficiencies, I will forgo suggesting how the systems development process should be performed. On the other hand, I will state that to conform with OMB Circular A-127 and *Financial Management and Accounting Objectives*, and because it is also common sense, new systems should not meet just one objective. Rather they should fulfill the five objectives appropriate for Federal Government financial management and accounting systems by:

- using contemporary technology, fulfilling standards of timeliness, reliability, and completeness, and operating within reasonable total and transaction costs;
- containing the appropriate internal controls;
- generating data that will facilitate budget preparation, analysis, and execution;
- providing a coherent, timely and accurate data base with which the agency can fulfill its financial management responsibilities; and
- providing the information necessary for full financial disclosure in accordance with appropriate principles and standards.

Furthermore, it is not necessary, and probably undesirable, to have a single massive financial management system providing all the processing to all the departments and agencies in the Federal Government. The Federal Government is a huge organization—with a considerable number of transactions. Any attempt at a single system would fail from the sheer size of the effort. In fact, many of the departments are so large, and so disparate in operations, that a single system, even for many departments, may be disfunctional.

A more rational approach would be to develop standard systems that can be replicated or modified in different agencies and departments. Many Federal agencies, as well as larger states, counties, and cities, already have systems that are effective and efficient enough to be considered for such replication.

The Federal Government must also reduce significantly the time consumed installing new systems. When implementations take five to ten years, as they frequently do, the agency is probably operating during the entire time with an inadequate system. Moreover, by the time the new system is operating, the needs have probably changed, the technology is no longer state of the art, and the system is obsolete.

Many factors contribute to these long time frames and most can be remedied easily. Examples are: a desire to custom design each new system rather than adopt available software; a procurement process that has too many unnecessary "boiler plate" requirements and that limits the involvement of the persons who must operate the systems after they are implemented; uncertain and often inadequate funding; the previously discussed higher turnover among financial management leadership and personnel, and a resulting lack of commitment to a single system; and the absence of incentives to complete the implementation quickly or even to avoid failure.

One solution deserving significant consideration is the systems development approach used by many state and local governments and nongovernmental organizations. These organizations frequently implement new financial management systems by obtaining and testing transferable, base point software packages used by similar organizations for the functions to be automated. They load the software onto their own equipment, modify it for their circumstances, and run real data against it, further modifying the software until the desired results are obtained. This approach has generally enabled system implementations to occur in a year, rather than a decade.

Accounting Principles and Periodic Public Financial Reporting

GAO believes the financial management improvement process requires each agency (and department) to periodically publish, for public consumption, a financial report that encompasses the entire agency. The report should be prepared in accordance with recently established accounting principles that, in many instances, differ from the accounting principles the agencies use to prepare reports for internal management purposes and submission to the Treasury. The purpose of the agency-wide report is not just to provide financial information to persons outside the agency. Having to prepare that report will ensure that each agency establishes the financial reporting discipline necessary for preparing a consolidated financial report for the entire government.

Agency-wide financial reports are a necessary step, but to be undertaken at the appropriate time. Public statements prepared from unreliable data generated by inadequate systems or systems established solely to meet the needs of new accounting principles are hardly worth the paper on which they are printed. Hence, the first step must be to develop the underlying systems. New York City, New York State, Washington, D.C. and other large state and local governments which, in the late 70's, concluded they did not have adequate financial management recognized this as the proper sequence.

Furthermore, the accounting principles must be meaningful for the Federal Government and the agencies. If the principles are not meaningful, the statements will not reflect appropriately the significance and the realities of the financial transactions and conditions. Nor will there be interest in using the statements or enthusiasm for preparing them.

Establishing meaningful accounting principles for the Federal Government and its agencies is not a simple task. The Federal Government has enough objectives and programs sufficiently different from any other organization to cause a need for accounting principles specific to the Federal Government.

For example, the Federal Government has a huge lending program, but the loans are not made to generate revenues and profits. Rather they are made to fulfill a public purpose such as promoting general economic development or assuring an educated citizenry. At issue is whether these objectives should be reflected by accounting principles unique to the Federal Government, or whether accounting principles written for other types of organizations' objectives can adequately reflect the impact of the artificially low interest rates for which these loans are made.

Similarly, the Federal Government is one of the only organizations in the country that can use a device called tax expenditures to forgo the right to collect revenues, and thus cause things to happen. Principles need to be developed to define how to account for and report tax expenditures.

The purchase, storage, and below-cost sale of farm commodities is another type of transaction for which there is no parallel.

Unfortunately, the existing professional accounting literature does not provide much foundation upon which accounting principles for the Federal Government can be built. The financial accounting standards (principles) developed by the Financial Accounting Standards Board (FASB) for profit making organizations are for the most part not appropriate. In fact, FASB recognized its standards are not necessarily appropriate for governments, and helped to establish the Governmental Accounting Standards Board (GASB). The GASB, in developing its standards, gives consideration to the needs of only state and local governments. Thus, the Federal Government must look elsewhere for the development of meaningful accounting principles.

Congress has delegated to the General Accounting Office the authority and responsibility to define accounting principles, standards, and related requirements for the Federal Government. There may be problems with this approach. Congress establishes the revenue and spending programs and levels for the Federal Government and the agencies. The GAO is an agency of Congress, serving at its behest. The possibility exists for Congress to influence GAO to establish one or more accounting standards that would mask the unfortunate results of a revenue or spending program or level it has or plans to establish. This is exacerbated by the GAO not having a publicly announced due process procedure for establishing accounting standards that is similar to the process used by other accounting standards setting organizations.

There is also the question of whether a group that is primarily the auditor of financial statements, and thus without the perspective of the statement user or preparer, is the proper group to establish the standards upon which the statements are based. The accounting profession learned in 1973 that establishing accounting standards is too important to leave to the auditors. It ceded the responsibility for this activity to the newly established Financial Accounting Standards Board.

Thus, the identity of an appropriate group to establish accounting standards for the Federal Government is not clear. One obvious approach is for the Comptroller General to formally delegate the task to the GASB when that organization feels it can broaden its perspective to also encompass the objectives and needs of the Federal Government. This would be similar to the Securities and Exchange Commission's delegation of its legislatively mandated responsibility to establish accounting principles for issuers of public securities to the Financial Accounting Standards Board. An approach the Comptroller General could follow until the delegation can be made would be to establish a due process procedure that broadens the base of the standards setting and thus avoids the appearance or actuality of undue Congressional influence; and then publish that procedure in order to inform the affected parties. Included in the broadened standards-setting base could be the Secretary of the Treasury and the Director of OMB—since the Budgeting and Accounting Procedures Act requires their consultation prior to prescribing the accounting principles, standards, and related requirements—and others selected through an open process.

In summary, the Federal departments and agencies presently prepare financial statements, in accordance with defined accounting rules, and these are available to external parties. New accounting and reporting principles can and should be phased in over time, provided they are deemed to be meaningful for the Federal Government and improve the information value of the financial statements. This process may heighten the public's interest in its government's financial statements, and even identify additional financial information that should be presented.

Audits of the Financial Reports

The final step in the financial management improvement program should be initiating the process of subjecting the published financial statements to an independent financial audit. As the Comptroller General has stated on several occasions, the independent financial audit process enhances the reliability of financial data. Also, the review of the systems and internal controls performed during a financial audit provides an identification of internal control weaknesses and other system deficiencies, and the development of recommended corrections and improvements which, if implemented, can help to further improve the systems.

The financial reports published by an entity should not be subject to a financial audit, however, until the system improvements discussed earlier in this paper have been made and there is a reasonable certainty that the data are correct. Auditors can audit virtually anything. If a financial system is not ready for audit, however, considerable time, effort, enthusiasm, and momentum can be lost. The absence of automated systems requires that the audit be performed with laborious manually-based audit procedures; the absence of reliable internal controls requires extensive testing of systems and individual transactions; and the numerous data errors that occur due to the absence of adequate control systems require extensive noting and recommending of adjustments.

As stated, this sequence was followed by New York City, New York State, Washington, D.C. and other major governments that moved, in the late 1970's and early 1980's, from virtually no coherent financial management program to a position of achieving the Governmental Finance Officers Association certificate for excellence in financial reporting. It was the same in every instance: implement a reliable financial management system; publish financial reports that conform with meaningful standards; obtain the independent financial audit.

It has been suggested by some that the audited statements should be a complete set, prepared for the department or agency as a whole, of the types of financial statements traditionally prepared by corporate entities, i.e., a balance sheet, a statement of operations, and a statement of source and application of funds. I believe the audit should be of those financial statements the agency would prepare to fulfill a legitimate informational purpose. Furthermore, it is premature to define the type, form, and content of appropriate financial statements for the Federal Government and its agencies, prior to developing relevant accounting principles and informational needs. Indeed, an examination of National Council on Governmental Accounting Statements Nos. 3 and 7, "Defining the Governmental Entity" and "Financial Reporting for Component Units Within the Governmental Reporting Entity" could lead one to question whether it is appropriate to consider each department and agency as the type of entity that would publish the financial statements identified above.

More suitable statements for a department or agency could well be a statement of revenues, a statement of expenditures—budgeted and actual, a schedule of accounts receivable, and other more limited statements that those involved with an agency or interested in its affairs believe are important for evaluating its stewardship and performance. Better yet, the statements should incorporate the reporting objectives the Department of Treasury Financial Management Service is defining in its project to update the agency financial reporting package. Examples of these objectives are:

- Ability to compare actual and planned uses of resources.
- Ability to assess performance.
- Ability to compare activities of similar operations across the government.
- Information on receivables to help project cash flow.
- Information on capital replacements.
- Information on liabilities and the implications for financial planning.
- Information on contingent liabilities and the possible exposure for the government.

Finally, there is a question as to how the audits should be performed and who should perform them. The Comptroller General has a statutory authority and responsibility to perform financial audits of Executive branch agencies' financial statements. Moreover, he has the independence to do so. He has stated on several occasions that he would expect to obtain substantial assistance from qualified public accounting firms. There is merit to this joint approach. The size and complexity of audits of Federal agencies will require the large numbers of skilled financial auditors and the modern audit techniques that a joint examination could provide.

Conclusion

The financial management improvement elements discussed above represent a formidable undertaking. It is difficult to be sanguine about it ever occurring to the extent necessary to eliminate the morass in which the Federal government's financial operations presently exist. However, each of the sections in this article, i.e., Personnel, Policies, Accounting Systems, contain suggestions that can contribute to the improvement of the entire function. Furthermore, if the first element, centralizing the responsibility for financial management within the Department of the Treasury, occurs, the others will follow as a result.

What is necessary, therefore, is that those who want to contribute to the improvement of financial management in the government focus on the first element and help to bring it about through Congressional hearings, Executive Branch actions, public education, etc. They will then have the pride of knowing that they were part of the effort that enabled the U.S. Government to again have the tools for establishing and maintaining adequate financial control.

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